INDEX

Page

TABLE OF AUTHORITIES

Cases:

Alstate Construction Co. v. *Durkin*, 345 U.S. 13 (1953) 82

Axe-Houghton Fund, Inc., Inv. Co. Act Rel. No. 1009 (1947), F. Sec. L. Rep. ¶ 75,740 101

Baum v. *Investors Diversified Services, Inc.*, 286 F. Supp. 914 (N.D. Ill. 1968), aff'd. on other grounds, 409 F.2d 872 (7th Cir. 1969) 113

Carnation Co. v. *Pacific Westbound Conference*, 383 U.S. 213 (1966) 87, 105

Chicago Mercantile Exchange v. *Deaktor*, 414 U.S. 113 (1973) 119

Continental Assurance Co., Inc., Inv. Co. Act Rel. No. 7488 (1972) 101

Dow Theory Investment Fund, Inc., 38 S.E.C. 286 (1958) 101

Federal Maritime Commission v. *Aktiebolaget Svenska Amerika Linien*, 390 U.S. 238 (1968) 111

First Multifund of America, Inc., Inv. Co. Act Rel. No. 6700 (1971), F. Sec. L. Rep. ¶ 78,209 ..... 40, 78, 101

Flood v. *Kuhn*, 407 U.S. 258 (1972) 82

Georgia v. *Pennsylvania R.R.*, 324 U.S. 439 (1945) 108

Gordon v. *New York Stock Exchange, Inc.*, 498 F.2d 1303 (2d Cir.), cert. granted, 43 U.S.L.W. 3290 (Nov. 18, 1974) 114, 115, 119

Page

Page

SECURITIES AND EXCHANGE COMMISSION DOCUMENTS:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA,
Appellant,

v.

NATIONAL ASSOCIATION OF
SECURITIES DEALERS, INC., *et al.*,
Appellees.

On Appeal From The United States District Court for the District of Columbia

---

BRIEF FOR APPELLEES BACHE & CO. INCORPORATED, DEAN WITTER & CO. INCORPORATED, DUPONT GLORE FORGAN INCORPORATED, HORNBLOWER & WEEKS-HEMPHILL NOYES INCORPORATED, E. F. HUTTON & COMPANY INC., MERRILL LYNCH, PIERCE, FENNER & SMITH INC., PAINE, WEBBER, JACKSON & CURTIS INCORPORATED, AND REYNOLDS SECURITIES INC.

This is an appeal from a judgment dismissing appellant's antitrust complaint. In the opinion of the

District Court (J. App. 333-62),[1] reported at 374 F. Supp. 95, Section 1 of the Sherman Act, 15 U.S.C. § 1, as amended, does not forbid certain practices engaged in by the appellees in connection with the sale and pricing of the shares of open-end management investment companies ("mutual funds") because of (1) the requirements and provisions of the Investment Company Act of 1940, 54 Stat. 789, as amended, 15 U.S.C. §§ 80a-1 *et seq.* ("1940 Act"), and the Maloney Act of 1938, 52 Stat. 1070, 15 U.S.C. § 78o-3, and (2) the exclusive jurisdiction of the Securities and Exchange Commission ("SEC") to regulate the practices challenged.

This brief in support of affirmance of the District Court's opinion is filed on behalf of eight securities dealers who were included among the named defendants in appellant's complaint.[2]

STATUTES INVOLVED

Contrary to appellant's brief (J.B. 3-5), a great number of statutory provisions are involved and support the District Court's opinion. For the convenience

---

[1] In this brief, "J. App." refers to the Joint Appendix; "J.B." refers to the brief filed by the appellant, United States (Justice Department); and "Add." refers to the Addendum to this brief filed by the appellee dealers.

[2] A ninth dealer defendant, Walston & Co., Inc., is in bankruptcy and subject to court order enjoining the continuance of lawsuits against it. The naming of these nine securities dealers as defendants was arbitrary or fortuitous, since hundreds of securities dealers are parties to the standard mutual fund sales agreements, publicly filed at the SEC, which are the principal remaining issue in this case, following appellant's abandonment in the District Court of its attack on the rules of the appellee National Association of Securities Dealers ("NASD"). See pages 19-20, *infra*. The appellee dealers are members of the NASD.

of this Court, the principal provisions of these statutes are set forth in the Addendum to this brief.

QUESTIONS PRESENTED

The question presented by this appeal is whether the District Court was correct in dismissing appellant's complaint upon the basis of its affirmative answers to the following three questions:

1. Does Section 22(f) of the Investment Company Act, by expressly sanctioning those transferability restrictions in mutual fund distribution contracts which are fully disclosed to and not disapproved by the SEC, thereby immunize such restrictions from antitrust attack?

2. Does Section 22(d) of the Investment Company Act, by requiring resale price maintenance in the sale of mutual fund shares (under sanction of criminal penalty), thereby immunize those who obey the statutory command from antitrust attack?

3. Do the Investment Company Act and the Maloney Act, by granting the SEC exclusive jurisdiction to permit or prohibit restrictions on the manner in which mutual fund shares are sold and redeemed, to control the industry self-regulatory activities of the National Association of Securities Dealers ("NASD"), and to regulate the flow of mutual fund market information to dealers and the public, thereby immunize those who comply with SEC regulation from antitrust attack?

COUNTERSTATEMENT OF THE CASE

1. The Nature and Distribution of Mutual Fund Shares [3]

An "investment company" invests in securities issued by other persons and issues securities of its own, usually in the form of common stock representing proportionate shares of the company's portfolio assets. An "open-end" investment company, popularly called a "mutual fund," continuously issues and sells new shares which, by law,[4] it must redeem upon the holder's demand.[5] These two features—continuous, unlimited distribution and compulsory redemption—are, as this Court recognized recently in *United States* v. *Cartwright,* 411 U.S. 546, 547 (1973), the "unique characteristic[s]" of mutual fund shares, radically distinguishing them from conventional corporate securities.

A mutual fund which sells its shares without imposing a sales charge or "load" is a "no-load fund." The present case, however, concerns the shares of three "*load* mutual funds," by far the most common

---

[3] See generally SEC, Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 4, 88th Cong., 1st Sess. at 95-99, 102-113 (1963) ("1963 Special Study"); SEC, Report on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2nd Sess. at 33-59, 201-50 ("1966 Public Policy Report"); SEC, Staff Report on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, Pt. I in F. Sec. L. Rep. Report No. 450, Pt. II (1972) ("1972 Section 22(d) Report, Pt. I").

[4] Section 22(e) of the Investment Company Act ("1940 Act"), 15 U.S.C. § 80a-22(e).

[5] A company which has outstanding, but is no longer issuing, such redeemable securities is a "closed-up" open-end company. An investment company which does not have outstanding, and is not currently offering, redeemable securities is a "closed-end" company.

type of mutual fund. To sell its shares, a load fund invariably enters into a distribution arrangement with a principal underwriter. That arrangement must, by law, be embodied in a written contract[6] filed at the SEC. Some principal underwriters maintain their own "captive" sales forces. The three appellee underwriters here, however, employ independent broker-dealers, including the appellee dealers named in this suit. Each underwriter has its own distinct contract form which, under an SEC-approved NASD rule,[7] a broker-dealer must sign before he can sell the particular fund's shares. Like the fund-underwriter contracts, these underwriter-dealer or "selling group" agreements must, by law, be filed with the SEC.[8] While each appellee underwriter is an exclusive wholesale distributor for a particular group of funds, each appellee dealer is a party to the selling group agreements of many competing funds and fund groups.

Investors obtain fund shares either by reinvesting dividends and capital gain distributions earned from their existing fund shares, by switching from one fund to another in the same group of related funds, and by purchasing directly from contract dealers. The first two types of purchases are usually at no load. Purchases from dealers are at an established "load" and are made pursuant to a "contractual plan," or in accordance with a "voluntary accumulation plan," or in a single, lump sum.[9]

---

[6] Section 15(b) of the 1940 Act, 15 U.S.C. § 80a-15(b).

[7] Rule 26(c), Art. III, § 26(c) of the NASD Rules of Fair Practice, CCH Manual ¶ 2176 (1974) ("NASD Rules").

[8] See page 91, *infra*.

[9] Under the contractual or "periodic payment" plan, the investor purchases a certificate issued by a "unit investment trust." The

As soon as a recently proposed NASD sales load rule (already tentatively approved by the SEC) takes effect, the maximum permissible sales load for mutual fund shares will be 8.5% of total payments. Even a lower ceiling will apply if the fund does not offer volume discounts, accumulation rights, and dividend reinvestments at no load. At the present time, sales loads for purchases of less than $10,000 are typically 8.5%, or $85 on a $1,000 purchase. After the investor makes payment, the load is returned from the fund to the underwriter in the form of a discount on the underwriter's order. The underwriter keeps a small fraction of the load for promotional and prospectus-printing expenses. The remainder goes to the dealer for selling expenses and profit.

Pursuant to an SEC-approved NASD rule,[10] the contract dealer may not maintain an inventory of fund shares. Upon receiving a solicited or unsolicited order, the dealer communicates the order to the fund

---

trust is, itself, an investment company with a portfolio consisting solely of shares in a specific underlying mutual fund. The investor pays in installments and, at any time, may redeem his certificate for cash or for the underlying fund shares to the extent of his payments. The investor pays a "front-end" load, *i.e.*, a charge for the total purchase to be made under the plan collected primarily from his initial installments. By law, the front-end load may not exceed 9% of the total payments to be made under the plan, and a somewhat higher percentage of the actual payments made on an uncompleted plan. 15 U.S.C. § 80a-27.

Under a voluntary accumulation plan, the investor buys fund shares directly by means of periodic purchases at established loads. If he does not complete the plan, he suffers no "front-end load" type of penalty. If he does complete the plan, his final installment may reflect a reduced sales load for the cumulative dollar value purchased. Similar volume discounts are usually available to lump-sum purchasers.

[10] Rule 26(f), NASD Rules.

or its underwriter for confirmation. At the close of the stock exchanges that day, the fund calculates the value of its portfolio and determines net asset value per share, as required by SEC rule.[11] Orders received prior thereto are confirmed at net asset value plus the applicable sales load established in the current fund prospectus. The sum of the net asset value and the load is the "public offering price" which Section 22(d) of the Investment Company Act[12] requires the investor to pay. The investor eventually receives a share certificate or some other evidence of ownership. To redeem, the investor either mails the certificate (or other evidence) directly to the fund or has a broker-dealer transmit it, usually at no charge. The redeeming investor receives net asset value calculated at the end of the day on which his redemption request is received.

2. The Only Real Market For Fund Shares

The just-described distribution-redemption system is commonly called the "*primary* market," although there has been virtually no *secondary* market in fund shares since the Investment Company Act was enacted in 1940. As this Court held in *United States* v. *Cartwright, supra,* 411 U.S. at 557, the only real market in mutual funds is the primary distribution-redemption "* * * market in mutual fund shares that the Act created and regulates." "Private trading in mutual fund shares is virtually non-existent." *Id.* at 549. There is, however, a "tiny *inter-dealer* market," not directly involving the public; it is, in the SEC's

[11] 17 C.F.R. § 270.22c-1 (1974).

[12] 15 U.S.C. § 80a-22(d).

words, "an extremely miniscule affair, almost a mere curiosity." [13]

Except for this inter-dealer "curiosity," which accounted for less than one-tenth of one percent of total 1970 mutual fund share sales,[14] there is not, and has not been since the 1940 Act, a *secondary* market involving dealer sales to the public. Recognizing that Section 22(d) of the 1940 Act unquestionably prevents the development of a price-competitive secondary *dealer* market, the appellant's principal objective in this suit appears to be the creation of a cut-price "secondary *brokerage* market" for the transfer of fund shares after their initial primary sale to investors. Under the appellant's theory, broker-dealers (including regularly soliciting, primary market, contract dealers) would act as commissioned agents selling and buying fund shares for investors at prices between the estimated public offering price and the estimated net asset value.[15]

Aside from the question whether such a "brokerage market" of the scale hypothesized would even be legal under the Investment Company Act (see Argument at pages 42 to 86, *infra*), there is every reason

---

[13] 1972 Section 22(d) Report, Pt. I at A-112 to A-113. A few firms, maintaining markets in a very limited number of mutual funds, sell shares to non-contract broker-dealers for retail to their customers at the statutorily required public offering price. These inter-dealer market-makers also purchase shares from broker-dealers whose customers prefer immediate cash to the slightly slower redemption process. *Id.*

[14] *Id.* at A-113.

[15] The range would have to be estimated because, in primary distribution, net asset value is determined at the close of the day and applied retrospectively to that day's sales and redemptions. See 17 C.F.R. § 270.22c-1 (1974).

to believe that this imaginary entity would never be practicable.[16] Although mutual funds have been distributing redeemable shares since 1924,[17] no "secondary brokerage market" for those shares has ever developed, even on an intermittent, limited, or single-fund basis.[18] The appellant concedes "that no such brokerage [market] actually exists today." J.B. 10 n.12. The appellant's chief trial attorney in this case even told the SEC, "I don't know exactly how the brokerage market would in fact work."[19] Indeed, he not only did not know *how* the "market" would work, he really did not know *whether* it would work. Regarding what he called "the possibility for it [*i.e.*, the brokerage market] working," his reluctant conclusion was "I don't know * * *."[20]

3. History of the Investment Company Act

Mutual funds, their underwriters and dealers, have been subject to federal securities legislation since 1933. The Securities Act of 1933[21] ("1933 Act") prohibited

---

[16] In the instant procedural setting, no doubt the complaint should be construed generally in the plaintiff's favor. Nonetheless, the complaint's description of this purely hypothetical, confessedly non-existent "brokerage market" does not make that market a fact, or make that market description "true" in any meaningful sense. Compare J.B. 6 n.4.

[17] Wharton School, A Study of Mutual Funds, H.R. Rep. No. 2274, 87th Cong., 2d Sess. at 4 (1962) ("Wharton Report").

[18] See page 74, *infra*.

[19] Hearings on Mutual Fund Distribution and the Potential Impact of the Repeal of Section 22(d), SEC File No. 4-164, Tr. at 2081 (1973) (Mr. Hunter) ("1973 Mutual Fund Distribution Hearings").

[20] *Id.* at 2081-082.

[21] 15 U.S.C. §§ 77a *et seq.*

funds from issuing shares unless the shares were covered by a current registration statement on file at the SEC. The Securities Exchange Act of 1934[22] ("1934 Act") supplemented the 1933 Act's disclosure requirements and subjected broker-dealers (including those who distributed fund shares) to SEC registration and discipline. The Maloney Act of 1938, adding Section 15A to the 1934 Act,[23] authorized broker-dealers to organize SEC-registered national self-regulatory associations for comprehensive supervision of members' over-the-counter activities, including mutual fund distribution, subject to ultimate SEC oversight. The appellee National Association of Securities Dealers ("NASD") is the only Maloney Act association ever formed.

As early as 1935, Congress acknowledged that the existing federal legislation did not begin to address the multiplicity of regulatory problems unique to the investment company industry. Congress directed the SEC to study investment companies, including mutual funds, with a view to further legislation.[24] The SEC conducted an exhaustive study and submitted to Congress over a four-year period a massive, multi-part report known as "The Investment Trust Study."[25]

---

[22] 15 U.S.C. §§ 78a *et seq.*

[23] 15 U.S.C. § 78o-3.

[24] Section 30 of the Public Utility Holding Company Act, 15 U.S.C. § 79z-4.

[25] Investment Trust Study, Pt. One, H.R. Doc. No. 707, 75th Cong., 3rd Sess. (1938) ("Investment Trust Study, Pt. One, H.R. Doc. No. 707"); Pt. Two, H.R. Doc. No. 70, 76th Cong., 1st Sess. (1939) ("Investment Trust Study, Pt. Two, H.R. Doc. No. 70"); Pt. Three, H.R. Doc. No. 279, 76th Cong., 1st Sess. (1940) ("Investment Trust Study, Pt. Three, H.R. Doc. No. 279"). There were

Among other things, the Study confirmed the existence of an active secondary market in mutual fund shares, popularly known as "the bootleg market," which was the equal of the authorized primary market in sales dollar volume. This "bootleg market," operated principally by non-contract dealers, was severely disrupting the primary market by competing against it in price and by fostering discrimination among investors.[26]

The SEC also produced a draft investment trust bill authorizing detailed regulation of funds, underwriters, and dealers.[27] After industry leaders testified before a Senate subcommittee in strong opposition to parts of the bill, the SEC and the industry were asked to formulate a compromise measure. Their substitute bill, developed through lengthy negotiations, was enacted. This Investment Company Act of 1940, 54 Stat. 789, 15 U.S.C. §§ 80a-1 *et seq.,* contained key provisions urged by the industry.[28]

Under the enacted compromise, unlike the first bill, the NASD was given initial responsibility for regulating sales loads and distribution practices (Sections 22(a) and 22(b)),[29] and the SEC was empowered to supplement and supersede where necessary (Section 22(c)).[30] Another provision from the original SEC

several supplemental reports, as well. See H.R. Doc. Nos. 380, 476, 477, 482, 567, 659, 76th Cong. (1939-41).

[26] See pages 26 to 30, *infra.*

[27] In addition, the SEC drew up companion legislation which became the Investment Advisers Act of 1940, as amended, 15 U.S.C. §§ 80b-1 *et seq.*

[28] See pages 32, 53-59, *infra,* for the detailed history.

[29] 15 U.S.C. §§ 80a-22a) and 80a-22(b).

[30] 15 U.S.C. § 80a-22(c).

draft was rewritten to clearly sanction the restrictions upon transferability which funds had been using to combat the "bootleg market." As redrafted, this provision—Section 22(f)[31]—said that such restrictions, would continue to be lawful, provided that they are disclosed in the funds' registration statements, unless and until contravened by SEC rules and regulations. In addition, at the industry's suggestion, an entirely new provision—Section 22(d)—was added. Section 22(d) prohibited the sale of mutual fund shares to the public, whether in a primary or a secondary market, at any price less than the applicable public offering price fixed in the fund's prospectus. Violation of Section 22(d)'s price-maintenance requirement was made a federal felony.

From 1967 to 1970, Congress, relying heavily upon extensive SEC studies and testimony, comprehensively reviewed the 1940 Act. Congress considered the SEC's proposal of a 5% sales load ceiling, subject to continuing SEC control. It weighed the Justice Department's counter-proposal that Section 22(d) be repealed so that each fund's shares would be open to price competition in primary and secondary markets. In its Investment Company Amendments Act of 1970,[32] Congress rejected both proposals. Congress fully reenacted Section 22(d) with a mere technical amendment. Congress amended Section 22(b) so as to strengthen the NASD's authority to promulgate reasonable sales load rules, subject to SEC alteration, and explicitly stated therein that such rules "shall allow for reasonable compensation for sales personnel,

[31] 15 U.S.C. § 80a-22(f).

[32] Pub. L. No. 91-547, 84 Stat. 1314.

broker-dealers, and underwriters * * *."[33] Congress expressly exempted this NASD-SEC regulation of sales loads from antitrust scrutiny.[34] Congress retained Section 22(f) in full, thus continuing to sanction transferability restrictions which are disclosed in registration statements and not prohibited by the SEC.

4. Pervasive SEC Regulation of Mutual Fund Sales and Pricing

The 1940 Act and its companion federal securities laws constitute a particularly "thoroughgoing statutory scheme to govern mutual funds."[35] No other issuers of securities are subject to such pervasive regulation, both directly and through their underwriters and dealers.[36] A complex matrix of statutory provisions, rules, regulations, and orders, makes this perhaps the most governmentally controlled industry to appear before this Court in an antitrust context.

The regulatory scheme with respect to the matters generally at stake in this case—sales, pricing, restrictive agreements, and investor information—is especially pervasive. There is extensive regulatory control over the content of documents filed with the SEC, intensive SEC supervision of NASD rulemaking, and elaborate rulemaking by the SEC itself.[37]

---

[33] 15 U.S.C. § 80a-22(b)(1), as amended.

[34] 15 U.S.C. § 80a-22(b)(4).

[35] Letter, Ray Garrett, Jr., SEC Chairman, to Senator John Sparkman, Chairman of the Senate Committee on Banking, Housing & Urban Affairs, Nov. 4, 1974, transmitting the SEC Staff Report, Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940 at v (August, 1974) (hereinafter "1974 Mutual Fund Report").

[36] *Id.*

[37] The details are described at pages 90 *et seq.*, *infra*.

Since before 1940, the very distribution agreements whose allegedly restrictive provisions form the crux of this lawsuit have been fully disclosed to the SEC in annual registration statements and periodic reports thereto. NASD Rule 26(c), since its approval by the SEC in 1941, has required dealers to become parties to such agreements before they could legally engage in any primary distribution of fund shares to the public. At all times, the SEC has had the power to alter or supplant Rule 26(c), pursuant to Section 22(c) of the 1940 Act, and also to issue rules and regulations under Section 22(f) of that Act prohibiting or limiting the alleged restrictions upon transferability in the publicly filed distribution agreements required by Rule 26(c).

Moreover, since 1940 the SEC has had the authority under Sections 6(c) and 38(a) of the Act[38] to issue broad exemptive rules, regulations, or orders to relieve regularly soliciting contract dealers from the challenged restrictive agreements and from the price maintenance mandate of Section 22(d). With the possible exception of a calculatedly limited rule permitting quantity discounts in primary market distribution, the SEC has chosen as a matter of conscious regulatory policy not to alter the basic system created by Section 22(d), Rule 26(c), and the distribution agreements. The SEC has intentionally protected the primary distribution system from competitive pressure and discriminatory pricing.

Over the last several years, at the specific request of Congress, the SEC has comprehensively reexamined its past policies with respect to the pricing and sale

[38] 15 U.S.C. §§ 80a-6(c) and 80a-37(a).

of mutual fund shares. In 1972, the Commission's staff compiled a massive study of Section 22(d) of the Investment Company Act and the economic impact which repeal of that provision might cause.[39] In several weeks of public hearings in early 1973,[40] the SEC heard testimony from approximately seventy persons and received more than a hundred written comments about the effects of Section 22(d), the desirability *vel non* of competition in the mutual fund industry, and related aspects of mutual fund distribution.

In November 1974, the Commission transmitted to Congress a report prepared by the SEC's Division of Investment Management and the SEC's own proposed "program" for major changes in the mutual fund industry.[41] The letter of transmittal flatly rejected the drastic infusion of competition which the Justice Department has persistently urged in statements to Congress, in comments and testimony to the SEC, and in pleadings in this case:

> As a general policy, the Commission believes it appropriate to promote efficiencies in securities distribution through retail price competition. However, implementation of this policy in the distribution of mutual fund shares is not an easy task. Simply stated, *it is our judgment that neither the industry nor the investing public would benefit from the disruption that might arise upon immediate repeal of Section 22(d).* Accordingly, the Commission does not recommend such a drastic step. Instead, we intend to exercise our

---

[39] 1972 Section 22(d) Report.

[40] 1973 Mutual Fund Distribution Hearings.

[41] 1974 Mutual Fund Report.

available administrative authority to encourage the industry to move toward competition.[42]

* * *

For more than three decades, the marketing strategy of the mutual fund industry has been to rely almost exclusively upon a sales "push" rather than a demand "pull;" or, as is often said, fund shares are "sold, not bought." In this environment, *it would be unrealistic to suppose that a sudden end to retail price maintenance would be accompanied by the level of investor sophistication and sensitivity to sales loads that would be needed to make a price competitive distribution system work. The more likely result of a precipitous end to retail price maintenance would be an end to widespread distribution of mutual fund shares, and most Americans would not have an opportunity to consider investing in mutual funds. As a consequence, many mutual funds—which by their nature tend to be self-liquidating and, therefore, require continuous distribution—would be adversely affected.*[43]

* * *

Therefore, the Commission has chosen a middle path, intended to reduce or eliminate many of the inequities and inefficiencies of the present fund distribution system while, at the same time, avoiding the dangers of a sudden abolition of retail price maintenance. *We have decided to exercise fully our existing administrative powers to lay the groundwork for the gradual and orderly introduction of retail price competition into the mutual fund distribution system.*

The Commission's aim is to allow the industry to adopt voluntarily programs designed to set

[42] *Id.* at ii (emphasis added).

[43] *Id.* at v (emphasis added).

the stage for retail price competition.[44]

As a first step in discovering whether and when full-scale price competition can be safely implemented, the SEC plans to experiment with price flexibility in two areas. It is revising its "traditional administrative positions" and "past restrictive Commission interpretations" under Section 22(d) to allow lower loads to specially situated groups and individuals buying in the primary market.[45] The SEC is also asking the NASD to amend its Rule 26 so that underwriter-dealer agreements do not prevent dealers from engaging in "genuine matching" of buy and sell orders in a limited secondary "brokered" market.[46] In this latter connection, the SEC fully intends to exercise its broad authority under Section 22(f) of the Investment Company Act to forbid contract restrictions which impede dealer participation in the limited "matching" market.[47] Nonetheless, by various regulatory "safeguards" the Commission fully expects to keep this limited "matching" from developing into a sizeable market that would impose substantial competitive threats on the statutorily protected primary distribution system.[48]

5. The History of This Litigation

On February 2, 1973, the Justice Department filed lengthy written Comments in the SEC's Mutual Fund

---

[44] *Id.* (emphasis added).

[45] *Id.* at iv, vi.

[46] Letter from Ray Garrett, Jr., SEC Chairman, to Gordon S. Macklin, NASD President, November 22, 1974, reprinted in Addendum hereto at Add. 18 ("Garrett letter").

[47] 1974 Mutual Fund Report at vi, 105, 105 n.1, 106, 109.

[48] *Id.* at 105, 107, 108, 109.

Distribution Hearings.[49] While urging the legislative repeal of the resale price maintenance system mandated by Section 22(d), the Department said:

> Furthermore, we believe that the Commission has the power under § 6(c) of the Investment Company Act to eliminate the adverse effects of the resale price maintenance provisions of § 22(d) and need not wait for repeal. We urge the Commission to use this power. [Comments 2-3.]

The Justice Department also dealt with the suggestion that, even if Section 22(d) were repealed, the funds would be able to forestall a price-competitive secondary market by restrictions on dealers' rights to redeem shares. The Department dismissed this problem by observing:

> However, the Commission could eliminate such difficulties, if they arise, by promulgating regulations prohibiting unreasonable restrictions on transferability pursuant to § 22(f) of the Investment Company Act. [Comments 13-14.]

In short, immediately prior to the lawsuit, the Department of Justice publicly recognized that resale price maintenance for mutual fund shares was mandated by Section 22(d) and that, even absent legislative action, the SEC had adequate statutory authority under Section 6(c) and Section 22(f) to deal with restraints on competition in the distribution of mutual fund shares.

On February 21, 1973, the Department, despite its written presentation in the SEC hearings less than three weeks earlier, filed this civil antitrust suit,[50]

---

[49] Comments of the Dept. of Justice, SEC File No. 4-164.

[50] Subsequent to the appellant's suit, some fifty private, treble damage, class actions based on similar allegations were commenced

alleging that long-existing, publicly acknowledged contractual restrictions concerning the manner in which mutual funds are sold and priced violate Section 1 of the Sherman Act, 15 U.S.C. § 1. Counts II through VIII attacked alleged restrictions on the sale of mutual fund shares, as set forth in the fund-underwriter and underwriter-dealer agreements annually filed in the funds' registration statements at the SEC. Count I challenged the legality of various NASD rules and regulations and alleged a horizontal conspiracy of the NASD and its members to stifle the development of a secondary "brokerage market" or secondary dealer market outside the statutorily price-fixed primary distribution system.

The District Court determined that it would first examine the basic, legal question whether the Investment Company Act exempted the alleged conduct from antitrust attack. At oral argument on defendants' motion to dismiss, the appellant apparently abandoned its attack on the NASD's rules. J. App. 328-32. Thereafter, the General Counsel of the SEC advised the court of the Commission's grave concern

---

in various federal district courts and transferred to the District of Columbia by the Judicial Panel on Multidistrict Litigation. One class action had been filed in the District of Columbia in December 1972, largely anticipating the theories advanced in the appellant's case. That and one other case were dismissed by the District Court at the same time that it dismissed the appellant's complaint herein. Appeals of those two cases to the U.S. Court of Appeals for the District of Columbia Circuit were stayed pending resolution of this appeal. The plaintiffs in one of those cases petitioned this Court for a writ of certiorari before judgment in the court of appeals, purportedly pursuant to this Court's Rule 20. That petition was denied, *Gross* v. *National Ass'n of Securities Dealers, Inc.*, 43 U.S.L.W. 3209 (U.S. Oct. 15, 1974). The remaining private actions have been stayed by the District Court pending the three appeals.

that the suit might involve an attack on the rules of the NASD "over which the Commission is granted exclusive original jurisdiction by Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-3, *et seq.* (the Maloney Act)." J. App. 323. Prior to the District Court's decision, the appellant confirmed its abandonment of those portions of Count I of its complaint which attacked NASD rules. J. App. 327.[51] On December 14, 1973, the District Court entered final judgment granting the appellees' motions to dismiss the appellant's complaint on the grounds identified in the Questions Presented (page 3, *supra*).

SUMMARY OF ARGUMENT

The Investment Company Act of 1940 created a pervasive scheme of SEC regulation over the sale and redemption of mutual fund shares. By that Act, Congress expressly substituted a system of mandatory resale price maintenance, coupled with protections against excessive sales charges, in place of "intra-brand" price competition in the sale of a single fund's shares. As an integral part of the price maintenance system, Congress also expressly authorized the mutual fund industry to employ contractual restrictions on the transferability of fund shares, provided that such restrictions are disclosed in SEC registration statements and do not contravene SEC rules or regulations.

For thirty-five years the mutual fund industry has complied with the statute's price maintenance requirements and has imposed contractual restrictions on transferability which have been fully disclosed to,

---

[51] It is difficult to follow this concession in appellant's brief. Compare J.B. 10-11 with J.B. 51.

and not prohibited by, the SEC. The entire distribution system, including the contractual restrictions, has operated under the daily scrutiny of the SEC and of the industry's Congressionally authorized self-regulatory body, the NASD. The NASD itself has operated under an umbrella of detailed SEC supervision and has supplemented the SEC's regulation of the most minute aspects of the sale, redemption, and pricing of mutual fund shares.

Prior to the filing of this lawsuit, appellant seemingly recognized that the price maintenance provisions of Section 22(d) of the Investment Company Act created a necessary exemption from the antitrust laws. Appellant further recognized that transfer restrictions in mutual fund sales agreements could be used to inhibit secondary market activities in fund shares and that the SEC had statutory authority under Section 22(f) of the Act to regulate the use of such restrictions. Indeed, appellant went so far as to contend that the SEC, through its exemptive power under Section 6(c) of the Act, could relieve industry members of their statutory price maintenance obligations.

The appellant, notwithstanding its prior acknowledgment of the SEC's jurisdiction, has recently tired of its efforts to interject greater competition into mutual fund sales through appeals to the SEC for administrative action or to the Congress for legislative action. Rather, seizing upon an alleged loophole in the price maintenance requirement of Section 22(d), the appellant has launched an antitrust attack upon selected representatives of the mutual fund industry, contending that these long-standing, publicly disclosed practices are not only violations of Section

1 of the Sherman Act, 15 U.S.C. § 1, but *"per se"* violations to which the appellees can adduce no defense based upon the reasonableness of their conduct.

The ultimate defense, as the District Court recognized, is the appellees' good faith reliance upon the exclusive jurisdiction of the SEC. The appellant cannot have it both ways: contending or conceding for three decades that the SEC has the authority to regulate these practices, then asserting by this lawsuit that the same practices are irrebutable violations of the antitrust laws.

Having abandoned its initial attack upon the rules of the NASD, appellant's lawsuit is now basically an attack upon the restrictions contained in the distribution agreements between the funds and their principal underwriters and between the underwriters and the dealers. Even though the appellees' agreements are an integral part of the SEC-NASD regulation of fund distribution, and even though the NASD rules require the use of such agreements, the appellant still refuses to acknowledge the SEC's exclusive jurisdiction over these agreements.

The District Court was correct in concluding that Section 22(f) of the Act necessarily immunizes these agreements from a conflicting application of the antitrust laws. The literal language of Section 22(f) shows that transfer restrictions may be incorporated in these agreements, subject only to the requirement that they be publicly filed as part of the fund's registration statements and not be in contravention of any SEC rules and regulations. The history of the Act further demonstrates that transfer restrictions aimed against the disruptions of the secondary market

were specifically the sort of restrictions which the industry had used and wanted to continue, subject to SEC supervision.

The District Court was also correct in its conclusion that Section 22(d) was intended effectively to preclude price competition in the sale of a fund's shares. Congress made this policy decision knowing full well that it would frustrate the growth of a free secondary market for fund shares. There is nothing permissive about Section 22(d). It does not merely "authorize" a "limited" exception to the antitrust laws. Thus, it is not analogous to "fair trade." What Section 22(d) does is to order that the fixed public offering price must be maintained by designated types of persons who might otherwise be in a position to disrupt the continuous, primary distribution system: the "principal underwriter" and both the contract and non-contract "dealer." Further, nothing in the history of Section 22(d) suggests that persons bound by its pricing requirements could evade the statute by the mere expediency of soliciting "brokerage transactions" in fund shares in a secondary market. Such activities would have been as disruptive of the primary distribution effort as the specific price-cutting secondary dealer market which Section 22(d) was designed to curtail. Even if the application of Section 22(d) were ambiguous, persons meeting the statutory definition of "dealer" would be ill-advised to "sell," *i.e.,* engage in any effort to sell, at other than the statutorily fixed price. The penalties for failure to comply with Section 22(d) are criminal.

Congress was reminded of this significant exception to the antitrust laws in its review of the Act in the late 1960's; but Congress elected to reenact Section 22(d). The legislative solution to the charge that

Section 22(d) fostered high sales loads for mutual funds was not repeal, but rather the placing of still greater regulatory authority in the NASD and the SEC through the Investment Company Amendments Act of 1970.

Today the SEC unquestionably has broad authority over the mutual fund industry. Appellees do not need to make an overblown assertion of antitrust immunity for all possible trade restraints relating to mutual funds. To affirm the lower court's decision, it is sufficient that the acts and practices which appellant has actually put in issue fall clearly within the SEC's jurisdiction. While Section 22(f) should in itself be a sufficient rebuttal to these allegations, the lower court properly noted that the SEC's jurisdiction is further confirmed by the entire statutory scheme, including in particular the exemptive and rulemaking authority of Sections 6(c), 22 and 38(a). As the SEC itself has recently noted, no other security is as heavily regulated as are mutual fund shares.

The SEC's jurisdiction is being actively exercised. Indeed, measured progress in the direction which appellant seeks will soon occur as the SEC's 1974 Mutual Fund Report is implemented. This task, however, must be left in the exclusive domain of the SEC. It is the agency with the expertise and the day-to-day control over the mutual fund industry sufficient to appreciate the manner in which competition must be regulated to maintain the industry's continuous, primary distribution of securities. There is no room for antitrust decrees which might flatly proscribe that which the SEC wishes to condone, or prescribe that which the SEC wishes to prohibit. This is the essence of exclusive jurisdiction. The SEC must have the one hand on the tiller.

ARGUMENT

I. SECTION 22(f) AUTHORIZES RESTRICTIONS ON TRANSFERABILITY OF MUTUAL FUND SHARES WHICH ARE DISCLOSED TO THE SEC AND NOT IN CONTRAVENTION OF SEC RULES AND REGULATIONS, EVEN THOUGH THESE RESTRICTIONS MAY INHIBIT A SECONDARY MARKET FOR SUCH SHARES.

The complaint (Counts II-VIII) alleges that the distribution agreements of the three appellee funds contain transferability restrictions which inhibit or prevent dealers from participating in competitively priced secondary "brokerage" and "inter-dealer" markets. In this portion of the Argument, we will show that Section 22(f) of the Investment Company Act, read both literally and in accordance with its history, authorizes the very restrictions upon transferability attacked by the complaint and thereby immunizes those restrictions from antitrust challenge.

Section 22(f) says:

> *No registered open-end company shall restrict the transferability* or negotiability of any security of which it is the issuer *except in conformity with* the statements with respect thereto contained in *its registration statement nor in contravention of such rules and regulations as the Commission may prescribe* in the interests of the holders of all of the outstanding securities of such investment company. [Emphasis added.]

The District Court said:

> Clearly, by § 22(f) Congress specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rulemaking authority of the SEC.

> Just as clearly *Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications.* [J. App. 354; emphasis added.]

The District Court, therefore, correctly held that Congress' express validation of contract restrictions—restrictions which the appellant describes as *per se* violations of the antitrust laws (J.B. 18)—necessarily frees those restrictions from antitrust challenge. J. App. 354.

While accusing the District Court of "misinterpret[ing] both the language and legislative history of Section 22(f)" (J.B. 43), the appellant is itself remarkably reluctant to focus on the actual words and syntax of that Section, as enacted, or to consult the most authoritative historical background on Section 22(f)—the SEC's Investment Trust Study of 1940.

A. Section 22(f) Was Drafted Against a Background, Described in the Investment Trust Study, of Contractual Restrictions Aimed at Combatting the Secondary "Bootleg" Market.

The Investment Trust Study described a secondary "bootleg" market which was quite active during the 1920's and 1930's, competing in price against the fund-authorized primary market and engendering discrimination among investors. The Study detailed how funds, through restrictive agreements and otherwise, were combatting that market. The Study revealed that, for ten representative mutual funds during a four-week period in 1936, fully one-third of the share and dollar volume of purchases and sales of fund shares resulted from dealings by firms who were outside the funds' authorized contract distribution sys-

tem.[52] Indeed, for all fund shares over a several year period, the dollar volume of secondary market sales probably exceeded primary market sales.[53]

Like contract dealers, the non-contract dealers, or "trading firms" as they were called, "acted as principals rather than as brokers, in practically all transactions."[54] "[T]he 'trading firms' tended to trade at prices between the official bid and asked quotations established by the principal distributors, thus making an unofficial market."[55] According to the SEC Study, "It is this market made by the 'trading firms' which is sometimes characterized as the 'bootleg' or 'price-cutting' market."[56]

In a part of the Investment Trust study concerned with "abuses and deficiencies in the organization and operation" of investment companies, the SEC described the disruptive effects of the "bootleg market":

> The so-called "bootleg market" was the market made by dealers who traded in the shares of open-end investment companies without the authority of the principal distributors of those companies. These dealers would often offer a little

---

[52] Investment Trust Study, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 326-27.

[53] For the period 1927 through 1936, the SEC estimated the total dollar volume of sales by mutual funds through the primary distribution process as $564 million, of secondary market sales by principal underwriters as $50 million, and of secondary market sales by dealers and trading firms as $564 million. Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 809.

[54] *Id.*, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 327.

[55] *Id.*; see Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 856-57.

[56] *Id.*, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 328 n.85.

> more than the published redemption price and ask a little less than the published sale price. In an active market, the unauthorized dealer could still get a greater spread than the authorized dealer. A certain amount of protection was received by such operators through their ability to obtain shares from the legitimate distributors if these dealers were short. Such operations actually had the effect of initiating a small scale price war between retailers and tended generally to disrupt the established offering price. Certain open-end investment companies attempted to overcome this by restricting the negotiability of their shares, providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company.[57]

As the quoted passage indicates, these "unauthorized dealers" or "bootleggers" managed to survive, in part, because the legitimate underwriters and contract dealers would sell shares to them. Indeed, as the Study revealed, some principal underwriters and contract dealers were themselves operating secondary markets, involving transactions with unauthorized dealers and directly with investors, while engaging simultaneously in primary distribution activities. Contract dealers were filling customer purchase orders by using their own inventories (comprised of shares purchased from the fund purportedly for the dealers' investment or purchased from investors and trading firms), by going short (i.e., borrowing shares for delivery), and by matching customers' buy and sell orders.[58] Thus, the contract dealer who also operated his own secondary market in a fund's shares was able

---

[57] Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 865 (footnotes omitted).

[58] *Id.* at 857-60.

to deprive the underwriter of its portion of the sales load and to undercut the primary distribution efforts of other contract dealers in that fund's shares.[59] Principal underwriters, too, used inventorying and secondary market activities to make extra trading profits at the expense of the funds or investors.[60]

As the Investment Trust Study reported, several funds adopted restrictive language in their underwriter and dealer sales agreements to combat the burgeoning secondary markets in fund shares. One fund prohibited its underwriter and dealers from buying for their own accounts and required that all orders be bona fide customer orders.[61] Another fund prevented its underwriter from accumulating an inventory for the underwriter's own trading account.[62] Another accomplished the same objective by amending its registration statement to forbid the underwriter from accumulating an inventory and from matching sell and buy orders.[63] In a fourth instance, "The selling contracts did not permit dealers to make resales of shares to persons other than bona fide investors without the consent of the * * * [funds] nor at any prices other than the established sales premiums [i.e.,

---

[59] The price-cutting was on the average about 2% on the retail level. Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279, at 810; SEC, Staff Report on the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, Pt. II at 292 (1972), ("1972 Section 22(d) Report, Pt. II").

[60] Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279, at 863-65.

[61] Id. at 828, 869.

[62] *Id.* at 868.

[63] *Id.* at 867-68.

loads].''[64] The Study recognized that such price-fixing eliminated any profit incentive for "the matching of purchases and sales by dealers * * *."[65]

B. The Language and Drafting History of Section 22(f) Confirm That It Was Intended to Validate Private Efforts to Restrain the Secondary "Bootleg" Market.

When it submitted its Investment Trust Study to Congress in 1940 the SEC sent along its draft of a proposed Investment Company Act. Section 22(d)(2) thereof, the forerunner of Section 22(f), said that the Commission was "authorized * * * to prohibit * * * restrictions upon the transferability or negotiability" of fund shares.[66] Mr. Schenker, chief counsel for the Investment Trust Fund, testified that the provision was designed to give the SEC regulatory authority over restrictions used by funds to combat the "bootleg market" described in that Study.

> MR. SCHENKER.
>
> * * *
>
> Now coming to subparagraph (2) of (d), it just says that the Commission shall have the right to make rules and regulations with respect to any restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer.

---

[64] Id. at 871 (footnote omitted).

[65] *Id.* at 871 n.372. One fund also restricted secondary market trading by declaring in its prospectus that shares were "nontransferable" to any person unless the fund consented to the transfer or failed to redeem the shares pursuant to the terms in the prospectus. *Id.* at 865 n.342.

[66] S.3580, 76th Cong., 3d Sess. § 22(d)(2) (1940). All of Section 22 of this SEC draft bill is printed in the Addendum to this brief, Add. 16-17.

There are some companies that have a provision in their certificates to the effect that you cannot sell that certificate to anybody else, and the only way you can sell it is to sell it back to the company. That is a technical problem. *It presents a whole problem which they call the bootleg market.* What happens is that dealers keep switching people from one company to another. In order to prevent these switches, some provisions require that you cannot make these switches but must sell the certificate back to the company. That is a big problem; but it seems to me they are taking away a very valuable indicium of the ability of the company, and it seems to me you are taking away a big portion of the owner's right of initiative.

If the committee wants the provision, we shall recommend what, on the basis of our experience up to the present time, it ought to be; but we think subjects like that ought to be a matter of rules and regulations.

SENATOR WAGNER. You provide rules?

MR. SCHENKER. That is right.

SENATOR WAGNER. You provide rules, I suppose, under which they make application to the Commission with respect to whether they may or not?

MR. SCHENKER. No. If this bill becomes law, and after we study the whole situation, if we feel there are abuses which cannot be corrected except by putting in a restriction on alienability, then we shall formulate rules, after discussing them with the industry.[67]

---

[67] Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking & Currency, 76th Cong., 3d Sess. at 292-93 (1940) ("1940 Senate Hearings").

As evidenced by Senator Wagner's closing question to Mr. Schenker, Section 22(d)(2) of the SEC's draft bill did not make clear whether existing restrictions upon transferability and negotiability would remain lawful pending SEC rules or regulations to the contrary. However, this ambiguity was resolved in the revised bill, which emerged from industry-SEC negotiating sessions,[68] by a change of language that clearly affirmed the continuing validity of such restrictions. Section 22(f) of the revised and enacted bill says that no fund "shall restrict the transferability or negotiability [of its shares] * * * except in conformity with * * * its registration statement nor in contravention of such rules and regulations as the Commission may prescribe * * *."

The earlier SEC provision was merely enabling legislation; it permitted the SEC to regulate on the subject, but nothing more. The enacted language goes much further. By saying "may prescribe" rather than "shall prescribe," Congress recognized that the SEC might find it inadvisable to immediately issue any prohibitory rules or regulations on such transfer restrictions.[69] The plain meaning of Section 22(f) is

[68] The fact that the industry's initial counterproposal failed to grant the SEC even a veto power over transferability restrictions (J.B. 46) is all the more reason for inferring that each side compromised somewhat in the private negotiations which followed. The subsequent SEC-industry compromise bill gave the SEC veto power, but sanctioned the industry's transferability restrictions *unless and until* that veto might be exercised.

[69] The Senate Committee report on the bill evidenced the same understanding: "The negotiability of open-end securities *may* not be restricted in contravention of provisions which *may* be formulated (Sec. 22)." S. Rep. No. 1775, 76th Cong., 3d Sess. 16 (1940) (emphasis added). The House Committee report is to the same

that the transfer restrictions *remain valid,* in the absence of SEC regulatory action, *provided* that they continue to be *fully disclosed in the registration statements* filed at the SEC. Section 22(f)'s phrase "except in conformity with" reinforces this plain meaning that restrictions, such as those described in the Investment Trust Study, are sanctioned *unless* and *until* the SEC exercises its exclusive jurisdiction to prohibit or modify them.

C. Section 22(f) Plainly Validates Restrictions Imposed By Underwriter-Dealer Agreements, Irrespective of State Law.

Without regard to the purposes and history of Section 22(f), the appellant contends (J.B. 42-8) that the provision applies only to that supposedly limited class of transferability restrictions which funds themselves are permitted by state law to print upon the face of share certificates. The appellant's argument is founded upon the wholly unsupported premise that Section 22(f) must be read in this narrow fashion in order to avoid any unintended preemption of state laws and, by analogy, any exemption from the federal antitrust laws.

1. It would be strange indeed if Congress meant Section 22(f) to apply only to "restraints in the alienability or negotiability of the *fund shares themselves*", as distinct from "restraints of the distribution mechanism * * *." J.B. 43 (emphasis added). Pre-1940 efforts to deal with the bootleg market were not, by

---

effect: "Subsection (f) provides that the negotiability or transferability of redeemable securities of open-end companies *may* not be restricted in contravention of rules and regulations which the Commission *may* prescribe." H.R. Rep. No. 2639, 76th Cong., 3d Sess. 20 (1940) (emphasis added).

any means, confined to the use of restrictions printed upon the face of fund share certificates, as the Investment Trust Study clearly shows. According to the Study, ***distribution contracts*** were frequently used to restrict "transferability."[70] Congress clearly expected that use to continue, wanted the fact of such use disclosed to the SEC in registration statements, and empowered the SEC to issue rules and regulations regarding all transferability restrictions, including those imposed by distribution contracts.[71] Had Congress meant ~~to~~ limit the Section to those restrictions which appear on the face of share certificates, it would have said so. Instead Congress provided simply that a Section 22(f) restriction, to be valid, must appear in the mutual fund's "registration statement." The word "certificate" is never mentioned.[72]

The SEC itself has never doubted that Section 22(f) extends beyond certificate-imposed restrictions. As far back as 1941, in conjunction with its description of NASD Rule 26(j)(2) as "a restriction upon the transferability of securities," the SEC noted that Section 22(f) also empowers the Commission to regulate "restrictions upon the transferability or negotia-

---

[70] See pages 29-30, *supra*.

[71] Although SEC counsel Schenker, in his 1940 Senate testimony, see page 31, *supra*, mentioned what may have been a certificate-disclosed transferability restriction, Schenker never intimated that then-Section 22(d)(2) would be confined to that limited type of restriction.

[72] Some mutual fund shares are not even represented by share certificates. See Inv. Co. Act Rel. No. 6366 (1971), F. Sec. L Rep. ¶ 77,966 (uncertificated shares); *e.g.*, GX 8, J. App. 254) (fractional shares). Those who are purchasing under contractual plans do not receive share certificates initially. See pages 5-6, footnote 9, *supra*.

bility of securities."[73] In its 1974 Mutual Fund Report, the SEC declared its intention to exercise that Section 22(f) authority against transferability restrictions imposed by *contract,* not by share certificates.[74] Plainly, therefore, the SEC does not believe its Section 22(f) power is confined to restrictions inhering in fund certificates.

2. The appellant seems to assert, albeit obscurely, that some of the alleged transfer restrictions are underwriter-imposed (*i.e.,* set forth in the underwriter-dealer sales agreements) rather than "fund-imposed" (J.B. 43) and, therefore, are outside the reach of Section 22(f). This argument ignores the following: (1) the Investment Company Act requires each mutual fund to enter into a distribution agreement with a principal underwriter,[75] (2) SEC-approved NASD Rule 26(c) requires the principal underwriter agreement to enter into a written selling group agreement with dealers, (3) the fund-underwriter agreement invariably provides that the underwriter will comply with NASD rules including the one requiring a selling group agreement, and, most importantly, (4) the fund must include both the fund-underwriter and the underwriter-dealer agreements in its registration statements filed at the SEC.

The appellee funds in this case have always been totally aware of any restrictive language in their selling group agreements, and have dutifully included those agreements in their registration statements and

---

[73] *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.,* 9 S.E.C. 38, 44-5 and n.10 (1941).

[74] 1974 Mutual Fund Report at 105, 105 n.1, 106.

[75] Section 15(b) of the 1940 Act, 15 U.S.C. § 80a-15(b).

other periodic filings at the SEC.[76] The funds have, in effect, authorized, approved, and ratified the agreements.[77] Indeed, given the close, continuing relationship between mutual funds and their principal underwriters (as contrasted with the usual arms' length relationship between conventional securities issuers and their underwriters), it would be odd indeed if Congress meant Section 22(f) to give the SEC regulatory authority over restrictions directly imposed by a fund on its affiliated underwriter, but not over dealer restrictions imposed on behalf of that fund by its underwriter.

The SEC has never construed Section 22(f) so narrowly. The 1974 Mutual Fund Report contemplates the possibility of SEC action against contract restrictions which are embodied in underwriter-dealer agreements.[78] Clearly, then, Section 22(f)'s sanctioning of properly disclosed transferability restrictions, subject to SEC regulation, applies to restrictions imposed by underwriter-dealer agreements as well as to restrictions imposed by fund-underwriter agreements.

3. The appellant raises a complete red herring: "Appellees have not contended that Section 22(f) preempts state law requirements, and there is no basis for such a claim." (J.B. 48.) There was no occasion in the court below for appellees to make such a contention. This case, after all, does *not* involve attempted enforcement of a *state* law in the face of a conflicting *federal* law. The case is an effort to enforce the *fed-*

---

[76] J. App. 155-56.

[77] The appellant itself alleges that one fund-underwriter agreement expressly requires that the underwriter's dealer agreement contain the restrictions now challenged in this suit. Complaint ¶ 29, J.App. 12.

[78] 1974 Mutual Fund Report at 105 n.1.

eral antitrust laws in the face of more recent, conflicting *federal securities* laws.

State laws are typically concerned with *disclosure* of restrictions *to the persons directly bound thereby.* Disclosure is not a problem here where the alleged transfer restrictions are embodied in contracts actually signed by the dealers. Apart from constructive notice through the public filing of these contracts at the SEC, the dealers, as parties to the contracts, have *actual notice* of restrictions upon their right to transfer fund shares.[79] The Uniform Commercial Code provision cited by the appellant (J.B. 47 n.40) does not *proscribe* transfer restrictions. If someone receives no notice, the restriction simply cannot be enforced as to him. Thus, there is no conflict between a state law *proscription* and a federal law (*i.e.,* Section 22(f)) *validation.*

In any event, the questions of state law preemption and federal antitrust immunity are not the same. The state laws described by the appellant can probably operate without conflicting with the SEC's regulatory jurisdiction. It is quite another thing, however, to suggest that the federal antitrust laws are not in conflict with SEC regulation under Section 22(f). The appellant as much as admits this by its contention that the restrictions at issue here are *per se* violations of the antitrust laws (J.B. 17-18). On its face, there is no way to reconcile the SEC's jurisdiction under Section 22(f) to approve, disapprove,

[79] Article 8, Section 204 of the Uniform Commercial Code, which provides that a restriction on transfer is "ineffective" unless conspicuously noted on the security, makes an express exception for "a person with actual knowledge of the restriction." See UCC Rep. Serv. ¶ 8204.

or otherwise regulate transfer restrictions with the appellant's contention that the same restrictions are irrebutably, *i.e., per se,* illegal under the federal antitrust laws. It is illusory to suggest in these circumstances that the SEC would still retain jurisdiction to impose "further limitations" on transfer restrictions (J.B. 44), for if the restrictions are *per se* illegal under the antitrust laws, there would be nothing left to which the SEC could properly add "further limitations."

D. The SEC Has Not Limited the Transferability Restrictions in Appellees' Agreements and Has Permitted Their Validation Under Section 22(f), Despite Full Knowledge of Their Restrictive Effects.

The record demonstrates that the appellees' distribution agreements, including any restrictions on brokerage and inter-dealer secondary market transactions, have met the validation requirements of Section 22(f) and, accordingly, are exempt from antitrust attack. As found by the court below (J. App. 354), it is undisputed that each appellee fund has filed its allegedly offending agreements, and all amendments thereto, with the SEC, in accordance with SEC-prescribed registration statement forms. There is no claim that the appellees have acted in any way "except in conformity with" those registered agreements. Thus, the appellees cannot be denied the protection of Section 22(f) because of any incomplete or improper disclosure of their agreements before the SEC.

As the District Court found, "[T]he SEC has never challenged the validity of uniform sales agreements." J. App. 354. In 1963, the SEC acknowledged in a report to Congress that restrictive clauses in these registered sales agreements complemented the provi-

sions of the Investment Company Act in preventing the development of a competitive secondary market:

> [T]he sales organizations are protected by "fair trading" or resale price maintenance in their sale of mutual fund shares under the Investment Company Act, the rules of the NASD, and *private sales agreements.*
>
> * * *
>
> In theory, without these fair trade arrangements, a trading market for mutual fund shares could exist, with purchasers buying at prices below the prices stated in the prospectus (net asset value plus, say, 8.5 percent) and sellers selling at prices above the contractual redemption price (net asset value). Prior to the passage of the Investment Company Act, indeed, there was such a market. The fair trade arrangements established by the act, the NASD rules *and the private sale agreements* now make it extremely difficult for a trading market in mutual fund shares to exist and to provide competition for the large mutual fund selling organizations in the sale of fund shares.[80]

The 1972 Section 22(d) Report, quoted by the District Court, (J. App. 354), recognized that "[o]ften the [selling group] contract requires him [the dealer] to place all orders with the principal underwriter and to refrain from any attempt to obtain shares from other sources."[81] Yet this sort of restriction, which the SEC for thirty-five years has knowingly declined to prohibit because of its contribution to the viability of the primary distribution-redemption system, is one

---

[80] 1963 Special Study at 98. As explained at page 52, *infra*, Section 22(d) does much more than the typical "fair trade" statute.

[81] 1972 Section 22(d) Report, Pt. I, 24, in F. Sec. L. Rep. Report No. 450, Pt. II at A-109.

of the principal restrictions under antitrust attack in this case.[82]

In adjudicated matters, the SEC has also focused upon the meaning and legality of the transfer restrictions in the funds' distribution contracts. For instance, in a 1971 action, the Commission quoted and discussed the restrictive language of two typical dealer agreements:

> In one [of the selling group agreement forms in the record] the underwriter states: "You agree to purchase shares through us at the offering price then in effect as agent for your customers or for resale to your customers as principal." In the other it states: "You agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors. . . ."[83]

In a 1972 opinion, SEC Commissioner Loomis, a former SEC General Counsel, stated unequivocally:

> I would conclude that applicant is a dealer in its relationship with the fund underwriter because to do otherwise would require us to ignore or *nullify the perfectly lawful requirement in the dealer agreements that applicant act as a dealer.* * * * [*I*] *do not know of anything unlawful about the generally accepted form of dealer agreement used in the investment company industry.*[84]

---

[82] See Complaint ¶¶ 23(b), 35(b), 47(b), and 58(c), J.App. 10-11, 13, 15, and 17.

[83] *First Multifund of America, Inc.*, Inv. Co. Act Rel. No. 6700 (1971) F. Sec. L. Rep. ¶ 78,209 at p. 80,602 n.7. The language quoted from the second agreement is, in fact, identical to the language used by The Crosby Corporation, one of the appellee underwriters in this appeal. See J. App. 36.

[84] *Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 at 7 (1972) (dissent) (emphasis added). The majority expressed

In its 1974 Mutual Fund Report, the SEC recognizes once again its exclusive jurisdiction under Section 22(f) over restrictions upon the transferability of mutual fund shares.[85] The SEC evidences for the first time, however, a desire to change some aspects of those contractual provisions which it has long permitted to exist.[86] In order to learn whether fund investors can be made price-conscious, the SEC proposes a heavily safeguarded experiment in price-sensitivity. The SEC would permit contract dealers to engage in "genuine matching" in a carefully circumscribed secondary brokerage market.[87] The Commission intends to accomplish this experimental objective through NASD rules and the exercise of its Section 22(f) authority. Conversely, while the 1974 Report evidences full knowledge of the allegations in this case,[88] the Commission proposes no comparable changes under Section 22(f) regarding contract restrictions which allegedly inhibit or prevent secondary inter-dealer transactions.[89]

This recent active assertion of SEC jurisdiction is all the more reason for antitrust enforcement to respect the exclusive jurisdiction which Congress has accorded to the SEC. The lower court was correct, and indeed foresighted, in its conclusion that these

---

disagreement with Commissioner Loomis on the facts of the case, but not on the legality of the selling group agreements.

[85] 1974 Mutual Fund Report at 105, 105 n.1, 106, 109. The Report is more fully discussed at pages 102-04, *infra*.

[86] *Id.*

[87] *Id.* 105-07.

[88] *Id.* at 104.

[89] Id. at 104-08. See page 104, *infra*.

antitrust challenges to mutual fund distribution agreements should be dismissed because of the irreconcilable conflict which they would cause to the SEC's authority under Section 22(f).[90]

II. SECTION 22(d) PROHIBITS CONTRACT DEALERS IN A MUTUAL FUND'S SHARES FROM PARTICIPATING IN SECONDARY BROKERAGE MARKET TRANSACTIONS IN THOSE SHARES AND, ACCORDINGLY, EXEMPTS FROM ANTITRUST CHALLENGE ANY ALLEGED AGREEMENTS NOT TO SO PARTICIPATE.

In this Argument section we will show (A) that the language and (B) that the Congressional history and the administratively and legislatively described purposes of Section 22(d), forbid a contract dealer in a mutual fund's shares from selling those shares as an investor's agent in the "brokerage market" hypothesized by appellant. As the District Court found, "brokerage transactions, necessarily executed in the secondary market, [are] within the prohibition of § 22(d)." J. App. 350. Thus, as that court held, any agreement which allegedly prohibits or inhibits such "brokerage transactions" is consistent with the statutory objective and does not violate the antitrust laws.

A. The Plain, Defined Terms of Section 22(d) Do Not Permit a Brokerage Transaction Exception from the Statutory Price Maintenance Obligation.

1. *Mandatory Price Fixing by Prospectus*

In relevant part, Section 22(d) says:

> No registered investment company shall sell any redeemable security issued by it to any per-

[90] See page 109 *et seq.*, *infra*.

son except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no pricipal underwriter of such security and *no dealer shall sell any such security to any person* except a dealer, a principal underwriter, or the issuer, *except at a current public offering price described in the prospectus.* * * * * [Emphasis added.]

The "prospectus" to which Section 22(d) refers is the investment company's current written prospectus filed at the SEC to meet the requirements of Section 10(a) of the Securities Act of 1933, 15 U.S.C. § 77j(a).[91] The "current public offering price," as used in Section 22(d), is the proportionate "net asset value" of the fund's portfolio investments plus a "sales load" to compensate the underwriter and dealer for their promotional and selling effort. Actually, the prospectus does not describe the "current public offering price" in precise dollars and cents. That is because the underlying asset value fluctuates daily and is calculated for a given day's fund share transactions on the basis of quotations for the fund's portfolio assets at the close of the stock exchanges that day. See 17 C.F.R. § 270.22c-1. The prospectus, however, does establish a fixed sales load percentage to be added to the daily asset value in order to form the selling price. In that sense, there is "a current public offering price described in the prospectus."

---

[91] See Section 2(a)(31) of the 1940 Act, 15 U.S.C. § 80a-2(a)(31).

2. *Express Exemption for Fund-Underwriter-Dealer Sales Only*

Under Section 22(d), neither the fund, nor its principal underwriter, nor a dealer, may sell fund shares "to any person" except at the same price as the "current public offering price" described in the prospectus for the particular purchase volume involved.[92] The three necessary exceptions to Section 22(d)'s otherwise flat ban on cut-price sales "to any person" are made *expressly*. The only such exception relevant to this case[93] is that discount sales may be made to "a dealer, a principal underwriter, or the issuer," but not to anyone else. This limited exception is perfectly understandable. Without it, mutual funds would have had to abandon their traditional practice of compensating their distributors by selling to them at discounts from the public price. That Section 22(d)'s draftsmen felt compelled to make these exceptions explicit, indicates that they neither intended nor expected that other exceptions would be implied. Consequently, the failure to insert into Section 22(d) an express exception allowing a dealer to sell to one investor from another in a cut-price brokerage transaction signifies that such an exception was never intended or desired.

3. *Definition of "Dealer"*

For purposes of this case, the key terms in Section 22(d)'s command that "no *dealer* shall *sell* any such

---

[92] When the fund offers quantity discounts for larger volume purchases, the prospectus fixes an applicable sales load for each volume level and, thereby, describes "a current public offering price" for each level.

[93] Exceptions for reorganizations and for certain offers made solely to existing shareholders are *expressly* stated in Section 22 (d)'s second sentence.

security to any person * * * except at a current public offering price described in the prospectus" are the underlined words "dealer" and "sell." Both are carefully defined in the Act.

Section 2(a)(11) says that "dealer"

> means *any person regularly engaged in the business of buying and selling securities for his own account,* through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business. [Emphasis added.]

The first thing to note is that "dealer" is defined as "any person." The statute's price maintenance command to "dealers" is directed at the "person" and not at the particular transactional capacity in which the "person" might choose to act.[94]

The second important aspect of the "dealer" definition is its requirement that the "person" be "*regularly* engaged in" an on-going "business."[95] The

[94] The SEC's pre-Act Investment Trust Study used the term "dealer" to mean dealer *qua* person, not a particular transactional capacity, *viz.*: "dealer * * * acted as agent," "dealer (for customer's account)," "where the dealer acted as principal," "if the dealer were acting as agent," "where both dealer and distributor acted as agents," "where a dealer acted as principal," "dealers acted as agent or as principal," and "the dealer acting as principal." Investment Trust Study, Pt. Three, Ch. III, H.R. Doc. No. 279 at 857, 858, 859, and 861. This was the authoritative study upon which the 1940 Act was based.

[95] Evidently, the draftsmen's choice of the word "regularly" was deliberate. In the SEC's 1940 draft of an investment company bill—a draft which did not include any provision resembling Sec-

definition does not focus on the person's "capacity" in a particular transaction at a particular point in time. It does not say that a person is a dealer "when, and only when" he makes a particular purchase or a particular sale for his own account. The definition simply requires that there be a level of *regularity* in the person's practice of engaging in the "business of buying and selling securities for his own account." Once that level is achieved, as in the case of regular contract dealers, then the "person" must comply with all the statutory commands directed at "dealers." In the case *sub judice,* it is undisputed that each of the appellee dealers is a "person regularly engaged in the business of buying and selling securities for his own account," including the shares of the appellee mutual funds.

A third important facet of the "dealer" definition is that where Congress intended an exception to that definition, it inserted that exception *expressly.* Section 2(a)(11) has four express exclusions: banks, insurance companies, investment companies, and persons who buy and sell securities for their own accounts "but not as part of a regular business." Plainly, there are no other express exceptions for persons who otherwise meet the occupational definition of "dealer." Congress would have added a fifth exception if it had intended that persons who meet the "dealer"

---

tion 22(d)—"dealer" was defined by referential incorporation of the "dealer" definition in Section 3(a)(5) of the 1934 Act, 15 U.S.C. § 78c(a)(5). See Section 45(a)(4) of S.3580, 76th Cong., 3d Sess. (1940). That definition said simply "any person engaged in the business," not "any person *regularly* engaged in the business." When Section 22(d) was added to the bill, a special definition of "dealer," with the inserted word "regularly," was also added.

definition might shed their statutory "dealer" price maintenance obligation in a given "brokerage" or "agency" transaction. Indeed, whenever Congress wanted the fact of a person's obligations under the Investment Company Act to turn on his particular transactional capacity, Congress invariably inserted *explicit* capacity-oriented language into either the applicable definition section [96] or the substantive provision itself.[97] A "brokerage" capacity exception was *not* inserted into the "dealer" definition or into Section 22(d).[98]

---

[96] Section 2(a)(8), 15 U.S.C. § 80a-2(a)(8), defines "company" to include a company receiver, bankruptcy trustee, or liquidation agent *"in his capacity as such."* Section 2(a)(17), 15 U.S.C. § 80a-2(a)(17), defines "insurance company" to include the company's receiver or liquidating agent *"in his capacity as such."* "Principal underwriter" is defined in such a way as to make references to the fact that the "principal underwriter" may be acting *"as principal"* or *"as agent"* and to make it clear that a dealer does not have the obligations of a principal underwriter when the principal underwriter is "acting as agent" for the fund. Section 2(a)(29), 15 U.S.C. § 80a-2(a)(29).

[97] Section 17(a), 15 U.S.C. § 80a-17(a) prohibits certain transactions between the investment company and a person affiliated with the company's principal underwriter if that person is *"acting as principal."* Section 17(d), 15 U.S.C. § 80a-17(d), bars such person from *"acting as principal* to effect any transaction" in which the investment company is a joint venturer with that person. Section 17(e)(1), 15 U.S.C. § 80a-17(e)(1), prevents the affiliated person *"acting as agent"* from accepting compensation (other than salary or wages) for the sale of property to, or for, the investment company "except in the course of such person's business as an underwriter or broker."

[98] If the appellant's transactional capacity analysis were available to unethical "dealers" in the industry, there might be attempted evasions of other provisions of Section 22. For instance, Section 22(c) of the 1940 Act, 15 U.S.C. § 80a-22(c), grants the SEC regulatory authority over "dealers" and others to prevent, *inter alia,* sales, repurchases, and redemptions effected by them in ways

It is the appellant, therefore, not the appellees, which seeks to "unjustifiedly expand" Section 22(d) and "read * * * into" it (J.B. 22) a brokerage capacity exception not expressly stated therein.[99] Appellees, on the other hand, would adhere to the definition of "dealer" that the statute itself supplies.[100]

4. *Definition of "Sell"*

The statute's broad definition of "dealer" takes on even more significance because the word is used by Section 22(d) in conjunction with the equally broad word "sell": "[N]o *dealer* shall *sell* any such security

---

which are "unfair to holders" of fund shares. (See reference to Section 22(a) therein.) As with Section 22(d), it defeats the statute's objective if a person who meets the occupational definition of "dealer" can, by purporting to "broker" shares, evade Section 22(c) regulations designed to protect investors from unfair results. For example, we doubt that the SEC subscribes to the view that a "dealer" may simply "broker" a repurchase from an investor at less than net asset value and avoid the clear prohibition in 17 C.F.R. § 270.22c-1 against such an unfair transaction. But see J.B. at 29-30 n.25.

[99] The appellant is not even consistent in its assertion (J.B. 22) that "brokerage transactions" are outside Section 22(d). The appellant concedes that when a dealer purports to act as an investor's "agent" in a distribution from fund to investor, the dealer's "brokerage transaction" is covered by Section 22(d)'s fixed-price mandate. J.B. 23 n.18.

[100] The fact that "broker" has its own definition in the 1940 Act, Section 2(a)(6), 15 U.S.C. § 80a-2(a)(6), instead of being subsumed under the definition of "dealer" as in the Securities Act of 1933, 15 U.S.C. § 77b(12), does not detract from the plain meaning of Section 22(d) and its defined terms "dealer" and "sell." A definition of "broker" was needed to clarify the meaning of several provisions of the Act unrelated to distribution and price maintenance of mutual fund shares. *E.g.*, Sections 2(a)(19), 10(b), 17(e)(2) and 31(a), 15 U.S.C. §§ 80a-2(a)(19), -10(b), -17(e)(2), -30(a).

* * * except at a current public offering price described in the prospectus." Section 2(a)(34) of the Act treats "sell" as a synonym for "sale," "offer to sell," and "offer for sale." The terms are jointly defined to include "every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." The Act supplies no separate definition for "selling as agent," as distinguished from "selling as principal." The single statutory definition applies in all cases regardless of how the seller might characterize his capacity in a particular transaction or attempted transaction.

Congress, therefore, has made it clear that, wherever the word "sell" is used in the Investment Company Act, it includes not only those activities which occur during the actual agreement, confirmation, and performance of a sale, but also *any and all of a person's efforts to obtain or effect a sale, whether successful or not.* In the context of Section 22(d), this means that a "dealer" may not solicit a sale to the public at less than the public offering price, either by an "offer to sell" or an "offer for sale" or a "solicitation of an offer to buy." The "dealer" may not offer to dispose of fund shares in such a sale, attempt to dispose of fund shares in such a sale, actually dispose of shares in such a sale, or enter into a contract for such a sale and disposition.[101] Section 48(a) of

---

[101] Under the federal securities laws, defined terms such as "sell" are to be given an expansive construction so as to ensure effectuation of the laws' purposes. *Mader* v. *Armel,* 402 F.2d 158, 160 (6th Cir.), cert. denied, 394 U.S. 930 (1968); *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 634 (2d Cir.), cert. denied, 389 U.S. 970 (1967); *United States* v. *Monjar,* 47 F.Supp. 421 (D. Del. 1942), aff'd, 147 F.2d 916 (3rd Cir.), cert. denied, 325 U.S. 859 (1944). Indeed, such

the Act, 15 U.S.C. § 80a-47(a), extends the selling prohibition to such activities when done "indirectly" by the dealer, or "through * * * any other person," or "by means of any other person."

Given these statutory definitions of "dealer" and "sell," as supplemented by Section 48(a), it should be readily apparent that Section 22(d) prevents the appellee contract "dealers" from participating in *any real effort,* whether as principal or as agent, to effect a sale to an investor in a brokerage market "match" at less than the applicable public offering price. For instance, if a retiring investor were to ask a dealer to sell shares in the hypothesized brokerage market provided that a price advantage was available there, the dealer legally could not *solicit* a matching offer to buy. Nor could he wait very long for the fortuitous arrival of an *unsolicited* buyer of an identical lot of the same fund's shares, given the risk that the selling investor might miss that day's redemption price and might be forced to accept a lower price thereafter.[102] Conversely, if a new investor were to ask a dealer to purchase shares in the brokerage market, the dealer legally could not *solicit* a matching offer to sell. In fact, since fund shares are long-term investments and since present holders have already purchased redemption rights as part of their initial sales load

construction is especially appropriate here where, unlike in the other securities laws, even *solicitation* is defined as a "sale." Compare the 1940 Act definition with Section 2(3) of the 1933 Act, as amended, 15 U.S.C. § 77b(3), and Section 3(a)(14) of the 1934 Act, 15 U.S.C. § 78c(14).

[102] Rule 26(f)(1) of the NASD's SEC-approved Rules of Fair Practice prohibits member dealers from withholding orders. In any event, no dealer would want to risk responsibility for missing the redemption price on the day of the order.

payments, soliciting them to sell their shares is generally considered improper.

5. *Criminal Penalties for Price Cutting*

Congress and the SEC have repeatedly cautioned[103] that a dealer who violates Section 22(d) exposes himself to *criminal* punishment[104] as well as other severe sanctions.[105] Respect for the law would steer any reasonably prudent "dealer" far from any selling activity that conceivably could be construed to fall under Section 22(d)'s prohibitions. Certainly when Congress made mutual fund price cutting a crime, it evidenced a clear desire *not* to allow the plain language and defined terms of Section 22(d) to be circumvented by loopholes of any sort, including a "dealer's" participation in cut-price, brokerage sales to investors.[106]

---

[103] See pages 75-76, *infra*.

[104] Section 49 of the 1940 Act, 15 U.S.C. § 80a-48, provides a $10,000 fine and two years' imprisonment for a willful violation of "any provision" of the Act. Anyone who aids or abets a violation is subject to criminal liability under 18 U.S.C. §2.

[105] The SEC may revoke a dealer's registration or apply lesser sanctions. See, *e.g., In re Bakos*, Inv. Co. Act Rel. No. 7469 (1972), F. Sec. L. Rep. ¶ 79,095. The NASD may expel the offending dealer or impose lesser penalties. See, *e.g., In re Sideris*, Exch. Act. Rel. No. 8816 (1970).

[106] The antitrust laws, of course, make price *fixing* a felony punishable by as much as three years' imprisonment and a $100,000 fine for individuals, and $1 million for corporations. Pub. L. No. 93-528, § 3 (Dec. 21, 1974), amending Section 1 of the Sherman Act, 15 U.S.C. § 1. While the Justice Department has not chosen the criminal route in this case, it would be most extraordinary if Congress intended mutual fund dealers to walk the tightrope which the appellant seeks to erect by means of this lawsuit. If the appellant's theories were to prevail here, a statutory "dealer" would be subject to criminal punishment under the *antitrust* **laws if he agrees** ***not to sell*** fund shares in cut-price *"broker"* transactions and he

6. *Sharp Contrast With "Fair Trade" Laws*

As the SEC and Congress have often acknowledged,[107] the price fixing system imposed by Section 22(d) is altogether different from state "fair trade" laws, whether of the "signer" or "non-signer" type. This is *not* a case like *United States* v. *McKesson & Robbins, Inc.,* 351 U.S. 305 (1956), where a federal statute simply *permits civil* enforcement under *state* law of *privately imposed* price maintenance requirements. Compare J.B. 14, 22, 24. Here, *Congress commands* strict price maintenance, regardless of state law or private enforcement initiatives, and it makes departures from price maintenance a *federal felony.* Rather than granting "a *privilege* restrictive of a free economy," *United States* v. *McKesson & Robbins, Inc., supra,* 351 U.S. at 316 (emphasis added), Section 22(d) *mandates* a *restricted* economy in order to preserve the unique continuous distribution system for redeemable mutual fund shares.

B. Participation by Fund Dealers In A Secondary Brokerage Market Would Contravene Section 22(d)'s Legislative History and Purposes.

We have just shown that Section 22(d), by its defined terms, prohibits funds, underwriters, and dealers from engaging in *any* sales to investors, including *any secondary market sales,* at less than the current public offering price. In adopting that interpretation, the court below correctly observed (J. App. 346-53) that such a reading of Section 22(d) is confirmed by the SEC's 1940 Investment Trust Study, the legislative history of Congressional actions in 1940

would be subject to criminal punishment under the *securities* laws if he *does sell* fund shares in cut-price "*dealer*" transactions.

[107] See pages 69, 75, 76, *infra*.

and in 1967-1970, and the SEC's many pronouncements regarding Section 22(d)'s purposes. The appellant, on the other hand, bases its case on the wholly unsupported belief that "a secondary market * * * was not a matter of concern to Congress" (J.B. 20) and that Section 22(d) "was not intended to eliminate competitive secondary markets." (J.B. 24).

1. *Section 22(d)'s Genesis Reveals Its Anti-Secondary Market Character*

Section 22(d) is best understood by reference to the historical setting in which it arose. As the District Court found, "in the pre-1940 period there was in fact a secondary market in mutual fund shares, a market very similar in size and scope as that for which plaintiffs here attempt to make a case." J. App. 347. We have related (pages 26 to 30, *supra*), the extensive findings of the SEC's Investment Trust Study regarding pre-1940 secondary or "bootleg" market activity in fund shares. Brokers and dealers who were not under contract to fund underwriters were selling shares among themselves and to the public at less than the prospectus-disclosed prices at which contract dealers were obliged to sell identical shares. Contract dealers were tempted, and in many cases forced by competitive pressure, to participate in such cut-price sales. The contract distribution system was disrupted, contract dealers cancelled their contracts, and investors were subjected to disillusioning price-discrimination.[108] The SEC's report to Congress recounted the variety of measures, including restrictive contracts, by which mutual funds and their under-

[108] See 1972 Section 22(d) Report, Pt. I, F. Sec. L. Rep. Report No. 450, Pt. II at A-115.

writers were attempting to eliminate the "bootleg" market.

Like the final version of Section 22(f), whose genesis has been described (see pages 30 to 33, *supra*), Section 22(d) was a direct outgrowth of the funds' battle against secondary market activity. The draft bill submitted by the SEC to Congress in 1940 did not contain any provision even remotely resembling present Section 22(d). The bill ran into heavy industry opposition at the first round of Senate hearings, principally because it had been written without sufficient consultation with responsible industry spokesmen.[109] The draft bill gave the SEC extensive power to regulate the industry, but gave the industry nothing in return.

Section 22(d) derived in part from a counterproposal designed to break the Senate hearing deadlock. According to the SEC, the provisions of Section 22(d) "were first suggested by members of the industry." [110] Apparently this occurred near the end of the first round of Senate hearings, when an industry spokesman proposed, *inter alia,* that Section 22 "provide that no securities issued by an investment company shall be sold to insiders or to anyone except on the same terms as are offered to other investors." [111] These exact words were incorporated in a memorandum of agreement in principle between the industry and the SEC shortly after the hearings recessed.[112]

---

[109] 1940 Senate Hearings at 406-07 (Mr. Bunker).

[110] *Midamerica Mutual Fund, Inc.,* 41 S.E.C. 328, 331 (1963).

[111] 1940 Senate Hearings at 1057.

[112] *Id.* at 1106; Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate & Foreign Commerce, 76th Cong., 3d Sess. at 99 (1940) ("1940 House Hearings").

The detailed give-and-take of SEC-industry negotiations during the several weeks before the Senate hearings resumed were largely secret. However, the concrete concessions gained there by the industry were plainly disclosed on the face of the resulting compromise bill. As noted *supra,* Section 22(f) was rewritten to specifically sanction fund-imposed restrictions on the secondary market activities of principal underwriters and contract dealers. Section 22(d) carried the logic of Section 22(f) one step further—into the secondary market activities of dealers who, lacking fund distribution contracts, could not be controlled by the funds under Section 22(f) and basic contract law. As the court below recognized, "The effect of the Act was for the first time to bind non-contract dealers to the public offering price." J. App. 348. When Section 22(d) said "no dealer," it meant no dealer, whether bound by contract or not, and whether engaged in primary or secondary market activity, or both.

Contemporary statements by opponents of Section 22(d), subsequent SEC pronouncements, and the whole tenor of Congressional hearings and debates in the late 1960's, confirm that Section 22(d) was aimed at suppressing secondary market activity because of its disruptive, price-competitive, and discriminatory character.

2. *Opponents of Section 22(d) Recognized in 1940 that it was Aimed at Their Secondary Market Activities*

Asiel & Co., an important factor in the active secondary or "bootleg" market of the 1930's,[113] cir-

[113] See Investment Trust Study, Pt. Two, Ch. IV, H.R. Doc. No. 70, at 326, n.80; see also 1972 Section 22(d) Report, Pt. II at 293.

culated a memorandum in August, 1940, entitled "Memorandum Covering S.4108," the Senate number for the pending industry-SEC compromise bill. J. App. 312. The memorandum said in relevant part:

> As we read Sec. 22(d) of the proposed bill, it will seriously curtail free "street" trading in the redeemable securities of open-end investment companies.
>
> * * *
>
> *If Section 22(d) goes into effect, it will be impossible for an individual investor or a broker to take advantage of the lower market made by the street* [*non-contract*] *dealer.*
>
> * * *
>
> It has been asserted that the operations of street dealers have resulted in certain abuses, and the enactment of Section 22(d) will eliminate these abuses. The claimed "abuses" are that the activities of the independent dealers:
>
> (a) Create unfair competition between "authorized" dealers (*i.e.* dealers in privity with the principal underwriters) and street dealers, to the prejudice of the former * * *.
>
> * * *
>
> *If the provision* [*22(d)*] *will achieve anything at all—and we think it was designed for this purpose—it will effectively hamper street dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly.* [J. App. 313, 315; emphasis added.]

Another self-acknowledged "street" trader in mutual funds, Goodbody & Co., stated in August, 1940, in correspondence filed at the NASD:

> You are no doubt familiar with the text and history of the Wagner-Lea Bill to regulate investment companies which has just been passed

by both Houses of Congress. We believe that this bill, which was drawn up with the assistance of a small committee of representatives of the underwriting houses, as a whole is an excellent bill. Due to the fact however, that brokers and dealers had no representation, it has been possible to insert into this bill a paragraph which only protects the underwriting houses but is detrimentally harmful both to the investing public and to the street.

The joker is to be found in section 22 paragraph D, which paragraph we together with others have vigorously but unsuccessfully opposed in Washington. A memorandum prepared by us and our Associates and sent to every individual Senator explaining our objection is enclosed herewith.

We doubt that it has been generally realized that under this section it will be illegal for a broker to come into the independent street market and buy for a client any mutual trust shares, unless his client is charged the full published offering price established by the underwriter. [J. App. 321.]

Clearly, those most concerned with preserving a competitive secondary market saw the handwriting on the wall in 1940. They knew that Section 22(d) was meant to destroy the principal economic incentive for such a market—the price advantage available to secondary market investors. As the secondary market participants recognized, Section 22(d) was unquestionably "designed for this purpose" of curtailing secondary market activity.

3. *The SEC Has Long Acknowledged the Secondary Market Objectives of Section 22(d)*

The appellant asserts that "Section 22(d) was addressed to abuses in the primary distribution of mutual

fund shares, *not to secondary level transactions.*"[114] J.B. 19-20 (emphasis added). This should come as a great surprise to non-contract firms, such as those just quoted, whose secondary market activities have all but disappeared since mandatory price maintenance was imposed in 1940. Moreover, SEC enforcement history flatly contradicts the appellant's view. According to the SEC, Section 22(d) unquestionably bars non-contract dealers from making secondary market sales to investors at less than the public offering price established by prospectus for primary distribution sales.[115] This is a clear administrative statement by the government agency most expert in the area that Section 22(d) was intended in 1940 to have a direct and destructive impact on secondary markets.

An assistant director of the SEC's mutual fund regulatory division has written:

> Although the reasons for section 22(d) were not articulated by its proponents at the legislative hearings, the objectives of the provisions were well known in the industry and to the Commission. These objectives have been described as (1)

[114] Appellant's concession that "non-contract dealers are bound by the requirements of Section 22(d)" (J.B. 7 n.7) does not candidly disclose that that provision binds them in true "secondary level transactions," *i.e.*, where the non-contract dealer buys from one investor and sells to another.

[115] *E.g.*, 1974 Mutual Fund Report at 118-121; 1972 Section 22(d) Report, Pt. I, F.Sec. L. Rep. Report No. 450, Pt. II at A-109; 1966 Public Policy Report at 220; Hearings on H.R. 9510, H.R. 9511 Before the Subcomm. of the House Comm. on Interstate & Foreign Commerce, 90th Cong., 1st Sess. at 48 & 701 (SEC Chairman Cohen) (1967) ("1967 House Hearings"); Hearings on S.1659 Before the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess. at 25 (1967) (SEC Chairman Cohen) ("1967 Senate Hearings").

> to insure the orderly distribution of open-end investment company shares, (2) to prevent discrimination or preferential treatment in price among members of the public, and (3) to prevent the cut-price competition which had then been making serious inroads upon the contractual distribution system of the mutual fund underwriting firms. In this connection the Commission's Investment Trust Study Report had described a so-called "bootleg" market.[116]

The SEC relied upon this historical explanation in its 1963 Special Study of Securities Markets.[117]

In rulemaking, enforcement, and exemption actions, the SEC has adopted the view that, *inter alia,* Section 22(d) was intended to prevent competitive inroads on the regular distribution system.[118] It has adhered to that view in its reports to Congress. For instance, in a written statement submitted in 1967 to the House subcommittee which was considering the proposed repeal of Section 22(d), the SEC left no doubt that the adverse impact of secondary market competition was, in the Commission's words, a "factor in the decision to give statutory sanction to price fixing in 1940 * * *."[119] The SEC explained:

---

[116] Greene, "The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940," 37 U. Det. L.J. 369, 371 (1960) (footnotes omitted).

[117] 1963 Special Study at 98 n.12.

[118] See, *e.g., Adoption of Rule N-22D-1*, Inv. Co. Act Rel. No. 2798 (1958), F. Sec. L. Rep. ¶ 76,625 at p. 80,393; *In re Sideris*, Exch. Act Rel. No. 8816 at p. 2 (1970); *Investors Diversified Services, Inc.*, Inv. Co. Act Rel. No. 3015 (1960), F. Sec. L. Rep. ¶ 76,699 at p. 80,620.

[119] 1967 House Hearings at 59.

Section 22(d) of the Investment Company Act has undoubtedly done much to shape the mutual fund industry into its present form.

* * *

Such competition as existed in the pre-1940 period seems to have had a truly disruptive effect on the relations between principal underwriters and dealers for two reasons. First, contract dealers were obligated to sell fund shares at the sales loads set by their principal underwriters while non-contract dealers were free to set their own price. Second, in those days principal underwriters kept more of the total sales load than they do now. * * * Because of these higher underwriting spreads, non-contract dealers were able to obtain shares either directly from investors or from over-the-counter trading firms at prices somewhat lower than the prices that contract dealers had to pay to the principal underwriters, which gave an incentive to dealers to cancel their contracts with principal underwriters.[120]

In a 1972 report to Congress, the SEC observed:

[T]he so-called "bootleg market" performed the service of distributing mutual fund shares at a lower cost than contract dealers. *Elimination of that market was considered to be a major motivation behind the enactment of Section 22(d).*[121]

It is misleading, therefore, for appellant to contend that the SEC "has recognized that Section 22(d) does not prohibit, but indeed *favors,* transactions in the secondary market at competitively fixed prices * * *." J.B. 40 (emphasis added).

---

[120] *Id.* (emphasis added).

[121] 1972 Section 22(d) Report, Pt. II at 292.

4. *The SEC Has Interpreted Section 22(d)'s Purposes To Be The Protection Of The Primary Distribution System And The Prevention Of Investor Discrimination, Which Purposes Would Be Contravened By A Cut-Price Brokerage Market.*

The historical purposes of Section 22(d) are twofold: (i) insulation of the primary distribution system from disruptive secondary market price competition and (ii) prevention of discrimination in the offering prices available to similarly situated investors, whether in primary or secondary market transactions. The court below made such a finding. J. App. 346, 348-49. Innumerable SEC decisions endorse that finding. For instance, in adopting its Rule 22d-1, 17 C.F.R. § 270.22d-1, the SEC said unequivocally in 1958:

> The purposes of this section are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus.[122]

The SEC has employed identical language several times.[123] In 1960 the Commission said:

> It is the purpose of Section 22(d) to prevent discrimination among purchasers of redeemable investment company shares and to prevent the purchase of such shares by dealers on the [sec-

---

[122] *Adoption of Rule N-22D-1*, Inv. Co. Act Rel. No. 2798 at 1 (1958), F. Sec. L. Rep. ¶ 76,625 at p. 80,393.

[123] *E.g., Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 at 4 (1972); *In re Sideris*, Exch. Act Rel. No. 8816 at 2 (1970); *Investors Diversified Services, Inc.*, Inv. Co. Act Rel. No. 3015 (1960), F. Sec. L. Rep. ¶ 76,699 at p. 80,620.

ondary] market and their resale at a price below the current offering price.[124]

In 1963, the Commission held that "An important objective of Section 22(d) * * * is to prevent discrimination or preferential treatment in prices." [125] In 1970, the Commission said "Section 22(d) seeks to prevent the adverse effect upon investors generally which would result from discriminatory pricing and disorderly distribution." [126]

This SEC understanding of Section 22(d)'s purposes is plainly at odds with the appellant's interpretation. Moreover, the unrestrained secondary brokerage market envisioned by the appellant would substantially undermine these two purposes of Section 22(d). As the District Court found, "It is an economic fact, recognized by Congress, that the two markets—the primary market * * * and a secondary market *as urged by the plaintiffs*—cannot co-exist and both remain viable." J. App. 346 (emphasis added).[127] Price pressure from a vibrant brokerage market would compel funds to reduce sales loads. That, in turn, would diminish dealers' incentives to push fund

[124] *Variable Annuity Life Ins. Co. of America*, Inv. Co. Act Rel. No. 2974 (1960), F. Sec. L. Rep. ¶ 76,688 at p. 80,599.

[125] *Midamerica Mutual Fund, Inc.*, 41 S.E.C. 328, 331 (1963).

[126] *In re Sideris, supra* at 2 (1970). On the discrimination point, see also Inv. Co. Act Rel. No. 89 (1941).

[127] Contrary to appellant's assertion (J.B. 39-40), the SEC's 1974 Mutual Fund Report hardly concedes that the unrestricted brokerage market sought in appellant's prayer for relief would not fatally disrupt the primary distribution system. The Report proposes a much more limited "matching" market, encumbered by numerous "safeguards" to ensure against any disruptive competition between markets. See pages 102-04, *infra*.

shares or even to continue as contract retailers because of the potentially unrewarding nature[128] and riskiness[129] of the whole undertaking. In a steadily declining stock market, with fewer and less-motivated fund dealers to counter redemption pressures, funds could expect a worsening net redemption situation and some could conceivably experience involuntary liquidation.

The brokerage market sought by appellant would also foster discrimination among investors who, on a given day, purchase identical quantities of shares in

---

[128] Once a contract dealer educates a potential investor to the advantages of mutual fund investment and gives him a prospectus, the dealers' selling efforts are deemed to be a "sale" and Section 22(d) applies to any further dealings with that investor. See page 49, *supra* Under appellant's theory, the actively soliciting dealer would, concurrent with his solicitation, have to inform the investor about a possible cut-price purchase in the secondary market. Yet, that dealer would be prevented by Section 22(d) from effecting such a secondary market transaction for the customer. The prospective purchaser could then turn to another broker-dealer who has not engaged in a technical "sale" as to him. The original dealer's selling efforts would go uncompensated while the second broker-dealer effects a "match" in the secondary market.

[129] A broker-dealer has the fiduciary obligation to promptly secure for his purchasing customers the lowest price available. *Kidder Peabody & Co.,* Exch. Act Rel. No. 8426 (1968), F. Sec. L. Rep. ¶ 77,618 To abide by this "best execution rule" the dealer would have the impossible task of comparing an unknown price with a frequently unavailable price. (The primary market price is unknown until after the close of the stock exchanges. 17 C.F.R. § 270.22c-1. The secondary "market" price is unavailable during the day until a selling investor fortuitously appears in that "market" with an identical lot of fund shares to sell.) In a rapidly fluctuating portfolio market, the dealer might "match" two of his customers during the day and find, by the close, that one or the other of the customers, or both, could have done better in the primary distribution-redemption market. This is but one of many legal and practical dilemmas to which broker-dealers would be exposed.

a particular fund. The sophisticated investor with up-to-the-minute information on portfolio values would know precisely when to go into the secondary brokerage market instead of the primary market for his purchases. If lucky, he could obtain a preferential price via a secondary brokered "match" while less sophisticated purchasers would pay that day's fixed public offering price. As the District Court found (J. App. 348-49), such discriminatory results are contrary to Section 22(d)'s intent.[130]

5. *Section 22(d)'s Principal Purpose Is Not Anti-Dilution*

The appellant brushes off Section 22(d) by contending that the price maintenance requirement "was enacted to protect open-end mutual fund investors against *dilution* of their equity due to 'in-and-out' trading by *insiders.*" J.B. 32-3 (emphasis added). In 1940, funds generally based the net asset value portion of the fund share selling price on the *previous* day's stock exchange quotations for portfolio securities. Those who could purchase fund shares without paying the additional sales load — underwriters, dealers, and in very rare cases, individual insiders— might buy their shares one day, sell the next, and, in effect, steal a portion of the fund's assets and thereby "dilute" the longer-term holdings of others.[131] By

---

[130] Contrary to appellant's contention (see J.B. at 39 n.35), the discrimination need not be "by the fund," in the sense that the shares in both transactions be taken down from the fund concurrently, in order to contravene Section 22(d). It is enough that contract dealers, plainly bound by Section 22(d), effect the discriminatory treatment of two similarly situated purchasers of fund shares.

[131] On Tuesday, the offending diluters would pay into the fund the cash equivalent of Monday's lower asset value for Tuesday's

forcing individual "insiders" to pay the sales load, Section 22(d) inevitably contributed to the elimination of dilution as a problem.[132] But this incidental effect of Section 22(d) on dilution affords no proper basis for ignoring the principal, historical objectives of Section 22(d). This is so for three reasons.

First, Section 22(a) and 22(c) of the Act already adequately handled the dilution problem.[133] Section 22(a) of the Act authorized the NASD to make rules respecting (1) the method of price computation in sales, redemptions, and repurchases of fund shares and (2) the minimum holding period for such shares. In Section 22(a)'s words, such NASD rules would be "for the purpose of eliminating or reducing so far as reasonably practicable any *dilution* of the value of other outstanding securities [of the fund] * * * or any other result of such purchase, redemption, or sale which is unfair to holders * * *." (Emphasis added.) Section 22(c) of the Act gave the SEC authority, beginning one year after the Act's effective date, to issue superseding rules "covering the same subject matter and for the accomplishment of the same ends

higher asset value and, on Wednesday, would redeem for the cash equivalent of Tuesday's asset value.

[132] Section 22(d) had *no* effect on underwriters' and dealers' ability to engage in diluting transactions, since *it* did not require them to pay the sales load. But *cf.* Section 22(a) described above.

[133] Section 22(a) of the original SEC draft bill would have given direct dilution-eliminating authority to the SEC. See S.3580 § 22 (a), and H.R. 8935 § 22(a), 76th Cong. (1940). The enacted bill, however, turned over the initial dilution rulemaking authority to the NASD and reserved ultimate authority to the SEC. See page 94, *infra*. Section 22 of S.3580, the SEC's 1940 draft bill, is reprinted in the Addendum at Add. 16-17.

* * *" as prescribed in Section 22(a). Thus, Sections 22(c) and 22(a) provided the SEC and the NASD, respectively, *full* rulemaking power to eliminate dilution-causing transactions. In 1941, the SEC approved NASD Rule 26 which tackled the dilution problem from several angles and radically reduced the potential for dilution by requiring *twice-daily* pricing. The SEC has now totally eliminated dilution by requiring *forward* pricing.[134]

Second, as even the appellant recognizes, "[a] *secondary* market could not contribute to dilution, whether by insiders or other investors * * *." J.B. 33 (emphasis added). Dilution was a *primary* market problem. Section 22(d) would not have imposed *secondary* market restrictions if its sole objective in 1940 were to eliminate cut-price opportunities for purchasing insiders who abused the *primary* market's then-existing pricing system. Were that the objective, the pro-

---

[134] Although Section 22(a) spoke of establishing a calculation method applicable to the price at which a "member" of the NASD might purchase or sell, nevertheless if the NASD were to promulgate a pricing method for transactions by member dealers and underwriters, such a method would in a practical sense inevitably cause the fund to adopt that method in its transactions with individual insiders as well as members. Similarly, Section 22(c), as it existed from 1940 to 1970, spoke only of rules "applicable to principal underwriters of, and dealers in," fund shares. Nevertheless, in its 1968 promulgation of Rule 22c-1, 17 C.F.R. § 270.22c-1, the SEC made its anti-dilution forward-pricing rule applicable to investment companies as well as underwriters and dealers. *Adoption of Rule 22c-1,* Inv. Co. Rel. No. 5519 (1968), F. Sec. L. Rep. ¶ 77,616. Though Congress in 1970 eliminated any ambiguity in the matter by inserting the words "registered investment companies" into Section 22(c) (see Section 12(b), Pub. L. No. 91-547 (1970)), Congress agreed with the SEC that the funds' potentially asset-diluting direct dealings with investors had always been encompassed by Section 22(c). H.R. Rep. No. 91-1382, 91st Cong., 2d Sess. 30-1, 54-5 (1970).

vision would have addressed only insiders and their *primary* market suppliers. Instead, the provision was plainly made applicable to *all* investor purchasers, insiders as well as outsiders, and their suppliers, whether dealers in the primary distribution chain or dealers in the "bootleg" *secondary* market.[135]

Third, in 1970 Congress carefully considered the proposed repeal of Section 22(d). By that time, as noted,[136] the backward-pricing system which had created the opportunity for asset-diluting transactions, was outlawed by the SEC. Since dilution was no longer possible, presumably Congress would have repealed Section 22(d)—*unless,* of course, Section 22(d)'s true purpose was *not* anti-dilution. As the next section of argument demonstrates, Congress in 1970 was fully aware of Section 22(d)'s genesis and its principal anti-competitive and anti-discriminatory purposes. Congress reaffirmed those purposes, did not discuss any anti-dilution purpose, and chose not to repeal Section 22(d).

6. *In 1970, Congress Rejected Repeal of Section 22(d) and Reaffirmed that Provision's Anti-Competitive, Anti-Discriminatory Purposes.*

In the 1960's a series of SEC studies and reports precipitated the first serious Congressional review of the Investment Company Act in the quarter-century since its passage.[137] The Justice Department[138] and

---

[135] See page 70, *infra.*

[136] See page 66, note 134, *supra.*

[137] 1966 Public Policy Report; 1963 Special Study; and Wharton Report.

[138] See 1967 House Hearings at 20, 21, 726-27; Hearings on H.R. 11995, S.2224, H.R. 13754 and H.R. 14737 Before the Subcomm. of

others[139]—but not the SEC—proposed the repeal of Section 22(d). This question was subjected to elaborate hearings and debates during four sessions of Congress. After meticulous examination of the origin, purposes, and enforcement history of Section 22(d), and its effects on competitors and investors, Congress rejected the idea of repeal.[140]

Surely, if the industry and the SEC had been misinterpreting the original intent of Section 22(d) with respect to the elimination of secondary market-caused disruption and discrimination, Congress would have taken the opportunity to either correct that misconstruction or repeal the provision.[141] Instead, Section 12(c) of the Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1314, *reenacted* Section 22(d) in full, with a technical amendment not material to this case. Congress left no doubt about its intent to insulate the primary distribution system from secondary market competition and to protect similarly situated investors from the discrimination which secondary market competition would foster.

---

the House Comm. on Interstate & Foreign Commerce, 91st Cong., 1st Sess. at 135, 136 (1969) ("1969 House Hearings"); H.R. Rep. No. 91-1382 at 50-1.

[139] See, *e.g.*, 1967 House Hearings at 591 (Mr. Wallich); Hearing on S.34 and S.296 Before the Senate Comm. on Banking & Currency, 91st Cong., 1st Sess. at 55 (Mr. Samuelson) (1969) ("1969 Senate Hearings"). And see the next footnote.

[140] In the 90th Congress, the Senate Banking and Currency Committee preliminarily recommended the repeal of Section 22(d), but then reversed itself. See 1969 Senate Hearings at 19; 113 Cong. Rec. 23055-056 (Sen. McIntyre) (1968). In the 91st Congress, the Committee rejected Senator McIntyre's repeal proposal, S.296. See S. Rep. No. 91-184, 91st Cong., 1st Sess. (1969).

[141] See *N.L.R.B. v. Bell Aerospace Co.,* 416 U.S. 267, 275 (1974) and cases cited therein.

On numerous occasions in the late 1960's witnesses reminded Congress that Section 22(d) created a "special exception from the antitrust laws."[142] The comprehensive SEC report which had precipitated the Congressional inquiry said, "Section 22(d) is an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing."[143] In urging repeal, the Justice Department advised "that Congress, in originally enacting the 'fixed price' provisions of section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws."[144] The SEC's Chairman explained that Section 22(d) was a more drastic departure from antitrust policy than the so-called "fair trade" laws which leave the initiative for the creation and civil enforcement of price maintenance to the manufacturer.[145] And, witnesses repeatedly reminded Congress that a willful violation of Section 22(d) was a *federal crime* regardless of the particular mutual fund's or underwriter's attitude toward price fixing in that fund's shares.[146]

Congress was told about the secondary "bootleg" market which existed prior to the passage of Section

---

[142] 1967 Senate Hearings at 87 (SEC Chairman Cohen); see, *e.g.*, 1967 House Hearings at 109, 156, 673, 691, 701, 707. See 113 Cong. Rec. 23056 (1968) (Sen. McIntyre).

[143] 1966 Public Policy Report at 218.

[144] 1967 House Hearings at 21.

[145] 1967 Senate Hearings at 25, 86; 1967 House Hearings at 140, 707; 1966 Public Policy Report at 222.

[146] 1967 Senate Hearings at 25-6, 86; 1967 House Hearings at 48, 109, 140. See H.R. Rep. No. 91-1382 at 3, 62; S. Rep. No. 91-184 at 7-8; S. Rep. No. 1351, 90th Cong. 2d Sess. at 7 (1968); 113 Cong. Rec. 23051 (Sen. Sparkman), 23055 (Sen. McIntyre), 23057 (Sen. Magnuson) (1968).

22(d) and was reminded that the Section had been enacted in order to eliminate price competition from such a market.[147] The SEC stated that Section 22(d) applies to secondary market activity in already outstanding shares, as well as to primary distribution of just-issued shares.[148] Congress heard repeatedly that, as a result of Section 22(d), intrafund price competition is legally impossible[149] and that there is "a sheltered, price-protected market for merchandisers of fund shares."[150] Professor Paul Samuelson observed that "Government now makes it impossible for there to be a free secondary market in mutual funds."[151]

Congress heard extensive testimony regarding whether repeal of Section 22(d) would lead to a renewed "bootleg" market and what that would mean for the future of the fund industry.[152] Witnesses weighed the dangers of abandoning what were described as Section 22(d)'s purposes—insulation against disruption caused by secondary market price competition[153] and prevention of investor discrimination.[154]

---

[147] 1963 Special Study at [illegible]; 1966 Public Policy Report at 219; 1967 Senate Hearings at 602-03 (NASD testimony).

[148] 1966 Public Policy Report at 218; 1967 House Hearings at 48,701; 1967 Senate Hearings at 25.

[149] 1967 House Hearings at 48, 59, 109-10, 655, 673, 691-92, 702-03, 811; 1967 Senate Hearings at 26-7, 32; 1969 Senate Hearings at 62; 113 Cong. Rec. 23051, 23057 (1968).

[150] 1966 Public Policy Report at 56.

[151] 1969 Senate Hearings at 62.

[152] 1967 House Hearings at 57-9, 586, 831; 1967 Senate Hearings at 356, 602-03; 1969 Senate Hearings at 18, 62, 65, 66, 103.

[153] 1967 House Hearings at 21, 143, 285-86, 827, 831; 1967 Senate Hearings at 216, 600, 608-09; 1969 Senate Hearings at 102, 206.

[154] 1967 House Hearings at 21, 58, 60, 113-14, 285, 294, 703, 714,

The Justice Department argued that repeal would not necessarily cause "disorder in the industry" or leave "the small and unsophisticated investor—the one most in need of protection—paying the higher price * * *."[155] The SEC disagreed. It urged the retention of Section 22(d) because of the "unsettling and unforeseeable effects which abolition of retail price maintenance might have on the broker-dealer community"[156] and because of the probable price discrimination between sophisticated and unsophisticated investors which would result.[157] SEC Commissioner Owens explained the Commission's rationale with respect to "bootleg" market competition:

> [W]e were apprehensive that as a regulatory agency we could not tell you gentlemen where a repeal of 22(d) would take us. There was apprehension and there still is, I might add, that we don't know what conditions will result in the marketplace if 22(d) is repealed.
>
> We are told that wildcatting and price-cutting will be ruinous to the industry. It well might be.[158]

SEC Chairman Cohen stressed the discrimination point:

> Thus, perhaps the very people most in need of protection would not get it from a repeal of sec-

---

790-91, 827, 832-33; 1967 Senate Hearings at 608, 1186-187; 1969 Senate Hearings at 102, 206.

[155] 1967 House Hearings at 21.

[156] 1966 Public Policy Report at 223.

[157] *Id.* at 222; 1967 House Hearings at 60, 113-14, 142-43, 703, 714.

[158] 1969 Senate Hearings at 18.

> tion 22(d), which would primarily benefit the more knowledgeable and sophisticated investor who might be in a position or be advised to shop around.[159]

Thus, Congress was fully apprised of Section 22(d)'s historical background and current effects, its anti-competitive and anti-discriminatory purposes, and its unique departure from traditional antitrust policy. In rejecting repeal of Section 22(d), Congress reaffirmed the Nation's policy *against* a price-competitive, secondary market in mutual fund shares. Congress heeded the advice of Congressman Stuckey who said: "We must not return to the cutthroat retail price competition in sales charges that existed prior to the 1940 Act."[160] In reporting favorably upon what became the Investment Company Amendments Act of 1970, both the Senate Banking and Currency Committee and the House Committee on Interstate and Foreign Commerce stated unequivocally that under the amended Act, "the sales loads fixed by the principal underwriters * * * continue to be protected against price competition by section 22(d) * * *."[161]

7. *Congress Never Intended That Section 22(d) Contain a "Secondary Brokerage Market" Loophole.*

Neither the 1940 Congress nor the 1970 Congress had any reason to believe that Section 22(d) would be applied to the secondary market any less comprehensively than to the primary market. Indeed, Con-

---

[159] 1967 House Hearings at 714.

[160] 116 Cong. Rec. 33283 (1970).

[161] S. Rep. No. 91-184 at 18; H.R. Rep. No. 91-1382 at 30.

gress premised its 1970 reenactment of Section 22(d) on the understanding, fully supported by SEC testimony, that the 1940 language *totally* insulates the primary system from *any* secondary market price competition.

The Senate Committee which reported favorably on Section 22(d) in 1940 spoke of it as a *blanket* prohibition with a *single, express* exception:

> In addition, provision is made to prohibit *the sale* of redeemable securities *to any person other than a dealer or principal underwriter* at a price less than that at which the security is sold to the public.[162]

When the chairman of the comparable House committee took the SEC-industry bill to the floor for a vote, he described Section 22(d) in words identical to those employed in the Senate report.[163]

Thus, when Congress voted in favor of Section 22(d) in 1940, it did so with the understanding that, whatever "the sale," the prospectus-fixed price had to be maintained. Indeed, in the context of that time, it would have been most strange if Congress had meant to bar price competition fostered by secondary market dealers, but not price competition engendered by secondary brokerage transactions arranged by dealer members of the fund distribution syndicate itself.[164]

---

[162] S. Rep. No. 1775, 76th Cong., 2d Sess. at 16 (1940) (emphasis added).

[163] 86 Cong. Rec. 9811 (1940) (Rep. Cole).

[164] As the Investment Trust Study revealed, even selling group members were participating in unauthorized "bootleg market" activities prior to the Act. See page 28, *supra*.

Given the limited ways in which investors might have purchased mutual funds just prior to the 1940 Act, the industry and the Congress certainly had every reason to think that Section 22(d)'s ban on price competition was effectively *total.* The Investment Trust Study had disclosed to Congress that, in both the primary market and the secondary market in fund shares, dealers "acted as principals rather than as brokers, in practically all transactions."[165] The rare exception was where a firm acted as agent for a purchasing investor in obtaining fund shares from the underwriter, from a contract dealer, or from a secondary market dealer.[166] Of course, even in such a "brokerage transaction," the sale would originate with the underwriter or a "dealer" and would be covered by Section 22(d) whether or not the firm which purported to be acting as the investor's agent also regularly solicited other customers' purchases of that particular fund's shares.[167] This rare exception, then, was the only way investors obtained fund shares by "brokerage transactions" in 1940; and even it was clearly covered by Section 22(d).

When the Act was undergoing reappraisal in the 1960's, Congress received expert SEC testimony regarding the all-encompassing nature of Section 22(d). No SEC witness gave any credence to the possibility of a "secondary brokerage" exception for contract "dealers." Fairly read, the SEC statements were di-

---

[165] Investment Trust Study, Pt. Two, Ch. IV, H.R. Doc. No. 70 at 327.

[166] See, *e.g., Mutual Funds Advisory, Inc.*, Inv. Co. Act Rel. No. 6932 (1971); J.App. 321.

[167] *Id.*

rectly to the contrary. For instance, the SEC Chairman testified:

> The statute is unequivocal. *No person, no matter where he gets it,* from the issuer, from another dealer, or *even from a private person, no broker-dealer* may sell a share of a particular fund at a price less than that fixed by the issuer.[168]

The Chairman's use of the word "broker-dealer" signifies, of course, that he saw no loophole for "broker-dealers" acting as "brokers." At another point, he characterized the regular fund sellers, such as the appellee dealers here, as "*brokers* selling fund shares" and "*brokers* who sell fund shares."[169] In fact, the SEC consistently maintained, throughout the 1967-1970 legislative inquiry, that the Investment Company Act totally insulated the primary system from secondary market price competition by virtue of the fact that Section 22(d) made price maintenance expressly applicable to *all* secondary market sales.[170]

Others testified to the same effect. The president of the New York Stock Exchange said that Section 22(d) gives "a fund the authority to say that its shares, *whenever sold,* should carry a certain charge."[171] Professor Samuelson, whose testimony fo-

---

[168] 1967 House Hearings at 711 (emphasis added). He also warned:

> If *someone* were to cut the price in the sale of the shares of a particular fund continually and deliberately, we might have the obligation of referring that to the U.S. attorney for criminal prosecution. [*Id.* at 140; emphasis added.]

[169] *Id.* at 53 (emphasis added).

[170] *E.g.,* 1967 House Hearings at 48, 701; 1967 Senate Hearings at 25.

[171] 1967 Senate Hearings at 741 (Mr. Funston) (emphasis added).

cused principally on the desirability of creating a competitive *secondary* market,[172] said Section 22(d) "prohibits a *broker* from selling mutual fund shares to the public at less than the public offering price."[173]

All of this testimony, which the District Court cited (J. App. 350), was demonstrably directed "to the application of Section 22(d) to secondary markets" despite appellant's present protestations to the contrary (J.B. 41).[174] Indeed, the appellant's own 1967 testimony in favor of repealing Section 22(d) made absolutely no reference to the supposed legality of a secondary *brokerage* market affording a degree of price competition even in the absence of repeal.[175]

The import of SEC and other expert testimony was not lost on the Congress. Senator Sparkman, chairman of the Senate Banking and Currency Committee which favorably reported the 1970 Amendments Act, said: "This Section [22(d)] now makes it a Federal crime for *anyone* to sell mutual fund shares at a price lower than that fixed by the fund's distributor."[176] Senator Magnuson observed that "mutual fund sales charges are *totally* insulated from price competition."[177]

---

[172] 1967 Senate Hearings at 348, 356.

[173] *Id.* at 348 (emphasis added).

[174] Appellant dismisses this testimony and other legislative comments and reports as that of "several persons." (J.B. 13.) Appellant neglects to identify these "persons" as the Chairman of the SEC, prominent academicians, individual U.S. Senators, and the House and Senate signers of official Congressional committee reports; see pages 76-77, *infra*.

[175] 1967 House Hearings at 21.

[176] 115 Cong. Rec. 838 (1969) (emphasis added).

[177] 113 Cong. Rec. 23057 (1968) (emphasis added).

The official Senate committee reports in 1968 and 1969 declared:[178]

> Under this Section [22(d)], *all dealers, regardless of the source of the shares they sell,* are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting *in this field* is a Federal crime.

The 1970 House report used nearly identical language.[179] Plainly, it was Congress' considered judgment that dealers, such as the appellee dealers here, may not legally sell to an investor at less than the public offering price "regardless of the source of the shares they sell," whether those shares are obtained through a primary or secondary market transaction or whether the selling dealer purports to act as principal or as agent.

Appellant cites several SEC publications (J.B. 37-9) that may conflict with the understanding of Congress in 1970. These publications were not disclosed to Congress and, if anything, were contradicted by the SEC testimony upon which Congress premised its reenactment of Section 22(d). That alone prevents them from controlling this Court's interpretation of the provision. See pages 81-83, *infra.* Moreover, those SEC publications which antedated the filing of this lawsuit were so dated and obscure that they were ignored and, in effect, contradicted in the SEC staff's 375-page study of Section 22(d), published in 1972.[180]

---

[178] S.Rep. No. 91-184 at 7-8; S.Rep. No. 1351 at 7 (emphasis added).

[179] H.R. Rep. No. 91-1382 at 3.

[180] 1972 Section 22(d) Report, Pt. I. The Report categorically stated:

> The absence of a [secondary] market does not hurt the mutual fund buyer. So long as 22(d) remains in effect, he has nothing to gain from an active trading market. [*Id.* at A-110.]

Except for the 1974 Mutual Fund Report, none of the SEC publications actually says that contract dealers who are regularly engaged in the solicitation and sale of mutual fund shares at the statutorily fixed price—as the appellee dealers are engaged on a daily basis—may concurrently engage in cut-price sales of those same funds' shares in a competing secondary brokerage market without violating Section 22(d).[181]

---

[181] Inv. Co. Act Rel. No. 87 (1941), addressed the situation of former "bootleg" traders who were anxious to obtain some relief from Section 22(d) and who had asked the NASD to inquire at the SEC on their behalf. The SEC General Counsel responded that such a firm might avoid Section 22(d) *only* if it were "acting *solely* in the capacity of agent" for one or both investors in a pure agent-arranged investor match. (Emphasis added.) In such circumstances, the firm would not be within the statutory definition of "dealer," which presupposes *a regular business of acting for one's own account* in shares of the particular fund. See pages 45-46, *supra*. The General Counsel did not intimate that a *contract* dealer, who *is* continually engaged in such a regular business for the fund involved, could *ever* be "acting *solely* in the capacity of agent" in a sale to an investor.

Oxford Co., 21 S.E.C. 681 (1946) involved a two-man firm which had egregiously violated its special fiduciary obligations toward two elderly ladies who were practically its only customers. Because of the unique circumstances of the case, the firm was *presumed to be acting for the account of these two customers* in its transactions for them. Accordingly, the firm could not be considered a statutory "dealer." There is no evidence that the *Oxford* firm was a regular, contract dealer selling to a variety of customers, nor that the Commission intended to extend the 1941 General Counsel's opinion, *supra*, to contract dealers.

Mutual Funds Advisory, Inc., Inv. Co. Act Rel. No. 6932 (1972), was not available to Congress in 1970. Even if it had been, Congress could not have deduced therefrom that the SEC was permitting contract dealers to participate as agents in sales at less than the public offering price. In fact, the Commission did *not* allow price-cutting in *Mutual Funds Advisory:*

> As we stated in First Multifund [Inv, Co. Act Rel. No. 6700 (1971)], the sale * * * is effected through [the broker] to the

The 1974 Mutual Fund Report purports to rely upon these prior releases.. Actually it extends them for the first time to regular contract dealers. This extension is unquestionably inconsistent with the SEC's 1967-1970 Congressional testimony and Congress' 1970 understanding of Section 22(d). It is also apparently inconsistent with several relatively recent actions taken by the Commission and relied upon by the District Court (J. App. 347, 351). [182] The 1974 Mutual Fund Report does not evidence any consideration of the statutory definitions of "dealer" and "sell" (see pages 44 to 51, *supra*). Nor does the staff report attempt to square its reading of Section 22(d) with the historical

---

> customer [in this case, Fundpack] . . . who pays the *current offering price as required by Section 22(d).* [*Id.* at 3; emphasis added.]

[182] In its Thirty-eighth Annual Report to Congress at 97 (1972), the Commission stated flatly, without exception, that

> Section 22(d) precludes *the sale to public investors* of redeemable investment company securities which are being currently offered to the public on or through an underwriter except at a current public offering price described in the prospectus. [Emphasis added.]

In 1971, the Commission approved new language to NASD Rule 26(e), Rules of Fair Practice, Art. III, Section 26(e), that clearly reflects the general industry and SEC understanding at that time that Section 22(d) prohibited members of the on-going primary distribution selling group from *any* participation in sales below the public offering price, regardless of the members' transactional capacity. The Rule, which is still in force and will remain so unless and until the SEC disapproves it (15 U.S.C. §§ 78o-3(k) and 80a-22(c)), says "No *member* shall offer or sell any such [mutual fund] security except at the effective public offering price * * *." (Emphasis added.) The member's purported capacity, as principal or as agent, is irrelevant. Presumably, the appellees were entitled to rely on such a rule, which the appellant rightly recognizes it may not attack (J.B. 51) and which, according to the SEC's letter to the District Court, is a matter within the "exclusive original jurisdiction" of the SEC (J. App. 323).

reasons for the provision's original enactment[183] or with the quite recent expression by Congress that the fixed sales load price of fund shares shall "continue to be protected against price competition by section 22(d) * * *."[184] Consequently, in this limited area of statutory construction, the Report is hardly authoritative.

We do not assert, however, that the SEC lacks the exclusive jurisdiction to enable contract dealers to legally act as agents in limited "genuine matching" of investors' orders. Short of obtaining a Congressional amendment of Section 22(d), the SEC might issue an exemptive order pursuant to Section 6(c) of the Act, supported by the SEC's broad authority under that provision[185] and under Section 38(a) of the Act.[186] So long as such exemptive order incorporates the regulatory safeguards against disruption of the primary distribution system, as mentioned in the 1974

---

[183] See pages 53 to 60, *supra*.

[184] See page 72, *supra*.

[185] See 1 L. Loss, *Securities Regulation* at 149 (2d ed. 1961).

[186] Section 6(c), 15 U.S.C. § 80a-6(c), empowers the SEC, *inter alia*, to conditionally or unconditionally exempt any person from any provision of the Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this Act." Thus, the SEC could conditionally free contract dealers from Section 22(d)'s price maintenance requirement to act as investors' agents in limited, genuine matching of investors' buy and sell orders. Section 38(a), 15 U.S.C. § 80a-37(a), empowers the SEC, *inter alia*, to issue rules, regulations, and orders, when necessary or appropriate, redefining terms used in the Act and prescribing different requirements in different matters. Accordingly, the SEC might define the terms "dealer" and "sell" in Section 22(d) to permit the contemplated special exemptive order for limited, brokered matches. See page 99, *infra*.

Report and in the SEC's implementing letter to the NASD,[187] the order presumably would not contravene Section 22(d)'s purposes, as originally conceived and as reendorsed by Congress in 1970. These safeguards, discussed more fully at pages 103 to 104, *infra*, should prevent the fortuitous, limited matching of non-inventoried buy and sell orders from developing into a price-competitive, secondary brokerage market similar in size, scope, and discriminatory effect to the "bootleg" market which Section 22(d) was meant to eliminate.

Whatever the SEC's exemptive authority to experiment with limited brokerage matching as part of a long-range, industry transformation program, however, the question for this Court is whether *Congress* meant to expose contract dealers to antitrust liability for agreeing not to "broker" at less than the Section 22(d) public offering price. Congress, after all, was told by the Chairman of the SEC that by reenacting Section 22(d), which applies to both primary and secondary markets, Congress was ensuring that "no matter where he gets it * * *, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer."[188]

Congress reenacted Section 22(d) on the basis of this authoritative SEC testimony and in the face of Justice Department pleas that the section be repealed so that a broker-dealer *might* legally sell "at a price less than that fixed by the issuer." In this setting, the SEC interpretation upon which Congress relied should control in interpreting the meaning of the re-

---

[187] Garrett letter, Add. 18-19.

[188] 1967 House Hearings at 711.

enacted provision. As this Court said last Term, "In these circumstances [of Congressional reenactment after careful appraisal of an agency interpretation] congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress." *N.L.R.B.* v. *Bell Aerospace Co.,* 416 U.S. 267, 275 (1974). See, *e.g., N.L.R.B.* v. *Gullett Gin Co.,* 340 U.S. 361, 366 (1951); *Massachusetts Mutual Life Insurance Co.* v. *United States,* 288 U.S. 269, 273 (1933); see also *Flood* v. *Kuhn,* 407 U.S. 258, 283-84 (1972); *State Board of Insurance* v. *Todd Shipyards Corp.,* 370 U.S. 451, 457-58 (1962).[189] This rule of construction applies even if the administrative interpretation relied upon by Congress arguably varies from prior administrative interpretations. See *Alstate Construction Co.* v. *Durkin,* 345 U.S. 13, 16-17 (1953). In any event, Congress' 1970 understanding of the provision it was reenacting prevails over the apparent SEC staff change

---

[189] The situation here is altogether different from that in *United States* v. *Philadelphia Nat'l Bank,* 374 U.S. 321, 348-49 (1963) cited by appellant (J.B. 41). There the Court properly concluded that it should not interpret a 1950 amendment on the basis of views voiced by a few Congressmen and Justice Department spokesmen several years *after* the amendment. Here the SEC interpretation of Section 22(d) was voiced *during* the reenactment process and relied upon by Congress *at that time.*

Appellant's reference (J.B. 41) to *S.E.C.* v. *Capital Gains Research Bureau,* 375 U.S. 180 (1963), is likewise inapposite. The issue there was not one of contemporaneous agency interpretation of a statute undergoing reenactment. Rather, the Court had before it the unpersuasive argument that the 1960 amendments to the Investment Advisers Act of 1940, adding "manipulative" practices to the original ban on "fraudulent" and "deceptive" practices, somehow narrowed the scope of the ban as to the latter practices. The 1960 legislative history was devoid of any administrative or Congressional support for such an argument.

of position in 1974. See *N.L.R.B.* v. *Bell Aerospace Co., supra,* 416 U.S. at 275, 288 (1974).

8. *Congress in 1970 Adopted An Antitrust-Exempt Self-Regulatory Scheme To Control "Excessive" Sales Loads And To Encourage Inter-Fund Price Competition.*

In 1970, while retaining Section 22(d)'s complete insulation of mutual fund shares from *intra*-fund price competition, Congress simultaneously amended Section 22(b) of the Investment Company Act in order to encourage *inter*-fund price competition. This is highly significant, since the appellant's confessed objective in attempting to impose by litigation a "brokerage transaction" loophole in Section 22(d) is to force down primary market sales loads via price pressure from a secondary market.[190] Yet, in 1970, Congress categorically refused an invitation to tamper with Section 22(d) as a way of reducing sales loads through competition. Instead, Congress gave the industry a mandate to *regulate,* with SEC oversight, against excessive sales loads. Congress expressly exempted that self-regulatory process from anti-trust scrutiny.

In 1966, the SEC had reported that load mutual funds tended to compete for the *salesman's* interest by *raising* sales loads rather than the *investor's* interest by *lowering* sales loads.[191] Although price competition *between* funds was not insubstantial,[192] the SEC believed that the *intra*-fund price-fixing feature of

[190] Complaint ¶ 59(b), J.App. 17.

[191] 1966 Public Policy Report at 56.

[192] See page 88, footnote 202, *infra*.

Section 22(d), along with other factors, had contributed to excessively high sales loads and less vigorous, investor-oriented *inter*-fund price competition. The SEC proposed that the Investment Company Act be amended to impose a 5% ceiling on sales loads and to empower the Commission to vary the ceiling by rule, regulation, or order.[193] The industry, which relies heavily upon underwriter promotion and dealer salesmanship, argued that such a drastic reduction in underwriter and dealer compensation would have destroyed the industry.[194] For the time being, at least, Congress agreed.

Section 12(a) of the Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1314, substantially amended Section 22(b) of the 1940 Act and renumbered it as Section 22(b)(1). The original provision had empowered the NASD to issue rules regarding only the "unconscionable or grossly excessive sales load," but new Section 22(b)(1) deleted the words "unconscionable or grossly." The amended provision, however, added the requirement that any NASD sales load rule "shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters * * *." Congress had heard extensive testimony regarding the importance of promotion, solicitation, and investor education to the proper functioning of the funds' continuous distribution process and the concomitant need for adequate sales loads to finance that effort. As the Senate Banking and Currency Committee said:

> In reporting this bill, your committee recognizes the importance of permitting adequate com-

---

[193] 1966 Public Policy Report at 223.

[194] *E.g.*, 1967 House Hearings at 274 *et seq.*

pensation and incentives so that men of ability and integrity will continue to be attracted to the mutual fund industry.[195]

The 1970 amendment empowered the SEC, after eighteen months, to alter or supplement the NASD's Section 22(b)(1) sales load rules "as may be necessary to effectuate the purposes of this subsection * * *." Section 22(b)(3), 15 U.S.C. § 80a-22(b)(3). Clearly, the maintenance of adequate sales incentives is one of the "purposes" of Section 22(b).[196]

The Maloney Act provision[197] which forbids the NASD from adopting rules "to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges" is made *expressly inapplicable* in the sales load context by Section 22(b)(1). And Section 22(b)(4), also added by the 1970 amendment, says:

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. [15 U.S.C. § 80a-22(b)(4).]

The committee reports explained:

> This provision which is identical to section 15A(n) of the [Maloney amendment to the] Securities Exchange Act, is designed to make it

[195] S. Rep. No. 91-184 at 4.

[196] Another new provision, Section 22(b)(2), empowers the SEC, after eighteen months, to adopt similar sales load rules to govern nonmembers of the NASD, but permits nonmembers to elect to be governed by the NASD's rather than the SEC's sales load rules. 15 U.S.C. § 80a-22(b)(2).

[197] Section 15A(b)(8) of the 1934 Act, 15 U.S.C. § 78o-3(b)(8).

> clear that no other provisions of Federal law, *including the antitrust laws,* prevents a registered securities association from adopting rules consistent with, and necessary to effectuate, the purposes and provisions of this section.[198]

In conclusion, it is evident that Congress intended to regulate excessive sales loads (and, in that sense, *inter*-fund price competition) through the existing NASD-SEC framework of cooperative regulation, *not* through the antitrust laws. Indeed, the decision to regulate sales loads in this fashion and, at the same time, to continue Section 22(d)'s absolute ban on *intra*-fund price competition are part of a Congressional policy judgment totally inconsistent with the rationale behind the present lawsuit.

III. THE SEC EXERCISES PERVASIVE REGULATORY AUTHORITY OVER THE CONDUCT IN QUESTION AND, ACCORDINGLY, THAT CONDUCT MAY NOT BE CHALLENGED UNDER THE ANTITRUST LAWS.

As we have seen, Sections 22(f) and 22(d) reject the usual antitrust policies against fixed prices and transferability restrictions. Section 22(f) is sufficient basis in itself for this Court to affirm the dismissal below of all secondary dealer and brokerage market claims; and Section 22(d) would warrant affirming the dismissal of the secondary brokerage market claims. In addition, as the court below found (J. App. 355-61), the specific conduct challenged by the complaint is governed by an *implied* antitrust immunity based upon the pervasive statutory and regulatory setting in which that conduct occurred.

---

[198] S. Rep. No. 91-184 at 18; H.R. Rep. No. 91-1382 at 30 (emphasis added).

This Court recognized in *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363, 385 n.14 (1973), that a comprehensive "statutory scheme that does not create a total exception from antitrust laws may, nonetheless, in particular and discrete instances by implication grant immunity from an antitrust claim."[199] As in *Hughes Tool* and similar controversies,[200] the present case is one of those "particular and discrete instances." The precise matters alleged are entrusted to the exclusive jurisdiction of the SEC, which currently has them under very active consideration.

The District Court expressly eschewed (J. App. 361) any holding that the Investment Company Act (or its companion federal securities laws) "completely displaces the antitrust laws" from all possible conduct respecting mutual funds. That question was not before the District Court and, of course, is not presented in this appeal.[201] The District Court's calculatedly narrow holding does not, despite appellant's exaggerated advocacy to the contrary, "oust the antitrust laws from the entire area" involving mutual funds (J.B. 56), nor accord "a general immunity from those laws" (J.B. 57), nor even supply an antitrust exemption for "all possible restraints in the distribution and sale of mutual fund shares" (J.B. 3). For example, the

---

[199] Accord, *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, 126 (1973), *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213, 219-20 (1966); *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 360-61 (1963); *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296, 304-05 (1963); *United States* v. *Borden Co.*, 308 U.S. 188, 200 (1939).

[200] See pages 109-15, *infra*.

[201] Compare *Carnation Co.* v. *Pacific Westbound Conference*, *supra*, 383 U.S. at 217 (1966).

complaint did not allege horizontal restrictions upon *inter*-brand competition, *i.e.,* competition *between* funds.[202] No defendant suggested below, and no appellee need contend on this appeal, that a covert, horizontal agreement to fix identical sales loads for various funds would necessarily be exempt from antitrust challenge.[203]

The District Court was well aware (J. App. 361) of this Court's oft-expressed view that implied displacement of the antitrust laws may be found only where direct antitrust enforcement is plainly inconsistent with the regulatory scheme. Accordingly, the District Court deliberately confined its holding to a "limited antitrust exemption" in the "narrow area" of conduct encompassed by this case. J. App. 361. It did so only after a painstaking examination of the broad panoply of quasi-legislative and quasi-judicial powers vested in the SEC by statute and a thorough documentation of that agency's pervasive exercise of such powers. J. App. 336-45, 358-59. The subsequent release of the SEC's 1974 Mutual Fund Report

---

[202] Vigorous and unfettered inter-brand price competition has always existed among the load funds themselves; between high, low, and no-load funds; and between open-end funds, closed-end funds, and other investment media. 1974 Mutual Fund Report at 20 *et seq.*

[203] Section 22(b)(1) of the Investment Company Act, as amended, 15 U.S.C § 80a-22(b)(1), however, does permit the NASD, through the collective action of its officers, committees, and members, to promulgate rules regulating the size of sales loads. These rules, which will have an obvious price-fixing effect, are subject to SEC review, disapproval, supplementation, alteration, and supersession. 15 U.S.C. §§ 78o-3(k), 80a-22(b)(3), and 80a-22(c). Such collective NASD action, despite its horizontal price-fixing character, is expressly immune from antitrust challenge. 15 U.S.C. §§ 78o-3(n) and 80a-22(b)(4). See pages 85-86, *supra*, page 95, *infra*.

confirms the wisdom of the District Court's decision to leave the matters alleged in the hands of the SEC's experts, who are uniquely qualified to resolve the complex regulatory issues at stake.

In previous cases of this sort, the Court has examined (1) the character, objectives, and pervasiveness of the Congressionally established regulatory scheme; (2) whether the conduct at issue is covered by that scheme and is in fact subject to the agency's authority; and (3) whether there is a direct conflict between the agency's exercise of its regulatory control and judicial application of the antitrust laws. Where a pervasive regulatory system actively governs the precise conduct at issue and irreconcilably conflicts with the antitrust laws, this Court has consistently found an implied Congressional intent to displace the antitrust laws. *E.g., Hughes Tool Co.* v. *Trans World Airlines, Inc., supra; Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296 (1963).[204] In the instant case there *is* such a pervasive scheme, the SEC *is* actively regulating the very conduct at issue, and there *is* an irreconcilable conflict with the antitrust laws.

---

[204] Appellant sets out its own criteria for implied immunity (J.B. 56) as if they were the inflexible requirements of this Court, which they clearly are not. Among other things, we take exception to the idea that the specific immunized conduct must always be the subject of an agency "proceeding," as such. That was not required in either *Hughes Tool* or *Pan American,* both *supra.* In any event, the on-going SEC implementation of its 1974 Report, coupled with other proposals, is surely in the broad sense a "proceeding" involving agency "remedial powers." Nor has this Court ever required that the agency possess *express* immunizing authority. If express immunity exists, the *implied* immunity question does not even arise. Certainly, it is possible for a subsequently enacted regulatory scheme to displace the antitrust laws *by implication alone.* *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 360-61 (1963).

A. The SEC Administers A Pervasive Regulatory System

We take exception to the appellant's assertion that in earlier cases, this Court was "faced with regulatory schemes more extensive and intensive than the present one * * *." J.B. 56. If anything, this is the most "extensive and intensive" regulatory scheme the Court has yet faced in an antitrust suit. The SEC has long been both mother and father to the mutual fund industry. It has carefully sheltered and nurtured the industry for thirty-five years. It has sharply disciplined its abuses. It has issued detailed rules, regulations, guidelines, and forms to control the industry. It is presently undertaking the orderly introduction of a limited degree of intra-brand price flexibility in mutual fund transactions. In sum, as the SEC told Congress in November, 1974, "No issuer of securities is subject to more detailed regulation than a mutual fund."[205] It is wholly misleading, therefore, to say that "underwriters, brokers and dealers are free to determine for themselves what is necessary for regulation of the mutual fund distribution network * * *." J.B. 54. As we explain below, such freedom from SEC control has not obtained since the passage of the Investment Company Act in 1940.

1. Filings at the SEC

Under the 1940 Act, a mutual fund must file a fund registration statement with the SEC in accordance with the SEC-prescribed form.[206] The statement must describe the method "to be followed by the registrant in determining the price at which its securities will

---

[205] 1974 Mutual Fund Report at v.

[206] Section 8(b) of the 1940 Act, 15 U.S.C. § 80a-8(b); 17 C.F.R. §§ 270.8b-10 & 274.11; Form N-8B-1.

be offered to the public, redeemed, or repurchased," furnish a specimen "price make-up sheet," state applicable sales load percentages, and describe any dividend reinvestment requirements.[207] SEC Guidelines provide sample "acceptable responses" on such matters as pricing, sale, redemption, and repurchase.[208]

Specimens of the fund's current agreement with its principal underwriter and the underwriter's current agreement with the fund's dealers—the very agreements involved in this case—also must be included in the registration statement.[209] To keep this information "reasonably current," the fund's registration statement must be updated quarterly[210] and annually.[211] Consequently, any change in the fund-underwriter and underwriter-dealer agreements must be included in the next quarterly and annual reports.

Periodic and annual reports to the fund's security holders must be filed promptly with the SEC.[212] Copies of all mutual fund sales literature intended for distribution to prospective investors, including the prospectus, also must be filed with the SEC.[213] The

---

[207] General Instructions as to Form N-8B-1, Item 30, 3 F. Sec. L. Rep. ¶ 51,293 at p. 39,263.

[208] Investment Co. Act Rel. No. 7221 (1972), 3 F. Sec. L. Rep. ¶ 51,301 at pp. 39,295 to 39,297.

[209] Instructions as to Exhibits to Form N-8B-1, 3 F. Sec. L. Rep. ¶ 51,296 Item 6.

[210] Section 30(b)(1) of the 1940 Act, 15 U.S.C. § 80a-29(b)(1); 17 C.F.R. §§ 270.30b1-1 & 274.106; Form N-1Q.

[211] Section 30(a) of the 1940 Act, 15 U.S.C. § 80a-29(a); 17 C.F.R. §§ 270.30a-2(a) & 274.101; Form N-1R.

[212] Section 30(b)(2) of the 1940 Act, 15 U.S.C. § 80a-29(b)(2); 17 C.F.R. § 270.30b2-1.

[213] Section 24(b)(1) of the 1940 Act, 15 U.S.C. § 80a-24(b)(1).

content of such sales literature is carefully controlled by the SEC's comprehensive Statement of Policy,[214] which is currently under study for possible revision.[215]

Under the 1933 Act a mutual fund must register its securities with the SEC prior to issuance and must keep that registration statement current as long as the fund continuously sells shares.[216] The 1940 Act provides that, in lieu of the usual 1933 Act registration statement, the fund may submit the registration statement and periodic reports required to be filed under the 1940 Act, plus such additional information as the SEC may require.[217] The SEC-prescribed form[218] requires inclusion of, *inter alia,* a current prospectus disclosing the same comprehensive information on pricing and sales load percentages as required by the 1940 Act registration form.[219] The SEC's prospectus guidelines set out detailed disclosure requirements with respect to such topics as "how to purchase the company's shares," "pricing for sales," "sales charge," and "repurchase, redemption, and market for shares."[220] The 1933 Act filing also must contain specimens of the fund-underwriter and underwriter-dealer agreements employed in the sale of fund shares.[221] To keep "reasonably current," changes in

[214] 3 F. Sec. L. Rep. ¶ 48,902.

[215] See Inv. Co. Act Rel. No. 8571 (1974), F. Sec. L. Rep. ¶ 80,001.

[216] Section 6 of the 1933 Act, 15 U.S.C. § 77f.

[217] Section 24(a) of the 1940 Act, 15 U.S.C. § 80a-24(a).

[218] Form S-5; see 17 C.F.R. § 239.15.

[219] General Instructions as to Form S-5, 1 F. Sec. L. Rep. ¶¶ 7172, 7173.

[220] 1 F. Sec. L. Rep. ¶ 7178 at pp. 6299-15 to 6299-20.

[221] Instructions as to Exhibits to Form S-5, ¶ 1, 1 F. Sec. L. Rep. ¶ 7177.

any aspect of the 1933 Act registration statement, including the prospectus and the agreements, must be indicated in quarterly and annual reports filed under the 1934 Act.[222] The 1940 Act periodic report forms are used.[223] Through deregistration and lesser sanctions under both Acts, the SEC is able to ensure that the documents filed with it accurately portray, and do not actively distort, the market for and pricing of mutual fund shares.[224]

2. SEC Control of NASD Rules

The Maloney Act grants the NASD broad powers to issue rules affecting over-the-counter transactions,

---

[222] Sections 14(a) & 15(d) of the 1934 Act, 15 U.S.C. §§ 78m(a) & 78o(d); 17 C.F.R. §§ 240.13a-12, 240.15d-1, & 240.15d-12.

[223] 3 F. Sec. L. Rep. ¶¶ 51,961 to 51,985, ¶¶ 52,102 to 52,104.

[224] If the SEC finds that a 1940 Act registration statement or report "omit[s] therefrom material facts" or "makes any untrue statement of a material fact" or omits "to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading," the SEC may suspend or revoke the fund's registration. Section 8(e) of the 1940 Act, 15 U.S.C. § 80a-8(e), which refers to Section 34(b) of the 1940 Act, 15 U.S.C. § 80a-33(b). Deregistration effectively terminates any lawful sale of fund shares. Section 7(a) of the 1940 Act, 15 U.S.C. § 80a-7(a).

If a fund's registration statement under the 1933 Act is "on its face incomplete or inaccurate in any material respect," the SEC may delay the effective date of registration until the statement is corrected. Section 8(b) of the 1933 Act, 15 U.S.C. § 77h(b). If it appears to the SEC "at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading," the SEC may, after notice and opportunity for hearing, issue a stop order suspending the effectiveness of the registration statement and precluding further offerings of the fund's shares. Section 8(d) of the 1933 Act, 15 U.S.C. § 77h(d); see, *e.g., T.I.S. Management Corp.*, 3 S.E.C. 174 (1938); *Managed Funds, Inc.*, 39 S.E.C. 313 (1959).

including the sale of mutual fund shares.[225] The Investment Company Act gives the NASD extensive authority to promulgate rules regulating the calculation of fund share prices, holding periods, and sales loads.[226] NASD exercise of this authority is always under the continuing surveillance and control of the SEC.

To qualify as a registered association under the Maloney Act, the NASD had to file a registration statement, accompanied by its corporate charter, bylaws, and rules. The SEC scrutinized NASD rules on the basis of strict statutory requirements[227] before approving the NASD's registration in 1939.[228] Since then, the NASD has had to file periodic amendments and supplements to its registration statement and whatever information it furnishes to its members.[229] Also, the NASD has had to submit proposed rule additions or changes to the SEC. These take effect upon the thirtieth day after filing, unless the SEC issues a disapproval order.[230] The SEC may abrogate NASD rules in order to assure "fair dealing," "fair representation," or to "protect investors" and effectuate the

---

[225] Section 15A(b) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(b).

[226] Sections 22(a) and 22(b) of the 1940 Act, as amended, 15 U.S.C. §§ 80a-22(a) & 80a-22(b).

[227] See Section 15A(b) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(b).

[228] *Application by Nat'l Ass'n of Securities Dealers, Inc., for Registration as a Nat'l Securities Ass'n,* 5 S.E.C. 627 (1939) ("1939 Registration").

[229] 17 C.F.R. § 240.15Aj-1.

[230] Section 15A(j) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(j).

statutory purposes.[231] The SEC may also request the NASD to alter or supplement its rules; and, if the NASD fails to comply, the SEC may order such changes itself, at least with respect to certain matters.[232] The SEC weighs competitive factors with other concerns in its continuing evaluation of NASD rules.[233] This system of Congressionally authorized, industry self-regulation, operating under the constant surveillance and control of the SEC, explicitly supplants other federal laws, including the antitrust laws.[234]

In 1941,[235] the SEC approved NASD Rule 26[236]

---

[231] Section 15A(k)(1) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(k)(1); *e.g., In re Nat'l Ass'n of Securities Dealers, Inc.*, F. Sec. L. Rep. ¶ 78,831 (S.E.C. 1972), aff'd without opinion, F. Sec. L. Rep. No. 504 at 5 (D.C. Cir. 1973) ("Aetna Case").

[232] Section 15A(k)(2) of the 1934 Act, as amended, 15 U.S.C. 78o-3(k)(2). In addition to its supervision of rulemaking, the SEC may, upon application or upon its own motion, review and alter any NASD disciplinary action, denial of membership, or restriction upon rights of association with non-members. Section 15A(g) & (h); 15 U.S.C. §§ 78o-3(g) & (h). The SEC may suspend or revoke the NASD's registration, suspend or expel its members, bar persons from associating with its members, and remove any of its officers or directors. Section 15A(l), 15 U.S.C. § 78o-3(l); 17 C.F.R. §§ 240.15b7-1.

[233] *E.g.*, 1974 Mutual Fund Report at vi, 105, 109; *In re Nat'l Ass'n of Securities Dealers (Aetna Case), supra*, F. Sec. L. Rep. ¶ 78,831 at p. 81,824; *In re Nat'l Ass'n of Securities Dealers, Inc.*, 19 S.E.C. 424, 436, 486-87 (1945) *(PSI Case); Proposed Amendment to The Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.*, 9 S.E.C. 38, 43-46 (1941) *(Rule 26 Approval); Application by Nat'l Ass'n of Securities Dealers (1939 Registration), supra*, 5 S.E.C. at 632.

[234] Section 15A(n) of the 1934 Act, as amended, 15 U.S.C. § 78o-3(n).

[235] *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.*, 9 S.E.C. 38 (1941).

[236] Art. III, Section 26, NASD Rules of Fair Practice, CCH NASD Manual ¶ 2176 (1974).

which, with a few revisions and the addition of one major paragraph, remains in force today as the principal Rule governing members' mutual fund transactions. It is through Rule 26, principally, that the NASD exercises the authority conveyed to it by Sections 22(a) and 22(b) of the 1940 Act. The Rule says that an NASD member may not purchase fund shares at a discount unless the selling underwriter is an NASD member, that a member underwriter may not sell to any non-member "dealer or broker," and that a member underwriter may not sell to any "dealer or broker" unless there is "a sales agreement" between the parties containing certain specific provisions of the Rule. (¶ (c).) The Rule states that "*No member shall offer or sell* any such [mutual fund] security *except at the effective public offering price* described in the current prospectus * * *," and adds that such offer or sale must be in accordance with SEC rules and regulations and interpretations thereunder. (¶ (e).)[237]

Rule 26 forbids withholding of customers' orders (¶ (f)(1)), and inventorying of shares (¶ (f)(2)), and bars conditional orders at indefinite prices (¶ (g)). It forbids redemptions and repurchases above net asset value (¶ (h)), requires that the sales load be returned to the fund whenever a purchaser redeems within seven days of purchase (¶ (i)), and prohibits contracting brokers and dealers from purchasing, as principal, from shareholders at less than the next-determined net asset value (¶ (j)(1)), but permits them to charge

---

[237] From 1941 to 1971, paragraph (e) required members to use twice-daily, rather than once-daily, backward pricing, as a way of reducing dilution. See page 64, *supra*. In 1971, it was amended to, among other things, take account of the SEC rule, 17 C.F.R. § 270.22c-1 (effective 1969), requiring *forward* pricing.

commissions for effecting sales back to the fund (¶ (j) (3)). An SEC-approved 1973 addition to the Rule forbids reciprocal arrangements (¶ (k)). Rule 26 presently proscribes "unfair" sales loads (¶ (d)). The SEC has tentatively approved[238] an amendment which would establish specific sales load ceilings and encourage low-load and no-load purchasing opportunities.

Since 1941 the Rule has, with the SEC's blessing, directly impeded secondary market activity. Paragraph (j)(2) prohibits any member underwriter from participating in the offer or sale of fund shares if the fund voluntarily redeems or repurchases from non-contract brokers or investors who are not record owners. The provision also bars underwriters themselves from repurchasing from non-record owners. In written and oral testimony, secondary market dealers vigorously opposed paragraph (j)(2) on two grounds —(1) that it unjustly discriminated against non-contract dealers by requiring them, but not the contract dealers, to become record owners, and (2) that it impeded the transferability of fund shares in a secondary market by forcing secondary market dealers to run the risk of redemption price changes during the time necessary to become record owners. The SEC refused to disapprove Rule 26(j)(2) despite its admittedly restrictive impact on secondary market activities, and hence upon investors' opportunities to dispose of their shares in such a market. The SEC observed that Congress never intended or expected "a free and open market" for mutual fund shares because of their unique characteristics, *i.e.,* continuous distribution and redemption, and market valuation

---

[238] Inv. Co. Act Rel. No. 8570 at 6 (1974), F. Sec. L. Rep. ¶ 79,998.

based not on the supply and demand for fund shares but on the supply and demand for the funds' portfolio securities.[239]

3. *SEC Rules and Exemptive Orders*

The 1940 Act entrusts the SEC with broad, almost "quasi-legislative," rulemaking and exemptive authority over the sale, redemption, and pricing of mutual fund shares. Section 12(b),[240] for instance, empowers the SEC to ensure, by rules and regulations, that funds distribute their shares through underwriters. Section 22(c),[241] *inter alia,* authorizes the SEC to issue rules governing price computation methods, holding periods, and sales loads. Section 22(e)[242] forbids funds from suspending shareholders' redemption rights and from postponing payments for more than seven days after redemption tenders, except in emergency circumstances defined by SEC rules and regulations. Section 22(f),[243] as fully described in Part I of the Argument, *supra,* entitles the SEC to prohibit, by rules and regulations, restrictions upon the "transferability or negotiability" of fund shares.

In addition to these specific rulemaking provisions, the Act contains an "elastic clause," Section 38(a),[244] which provides that the SEC shall "issue, amend, and rescind such rules and regulations and such orders

[239] *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.,* 9 S.E.C. 38, 46 (1941).

[240] 15 U.S.C. § 80a-12(b).

[241] 15 U.S.C. § 80a-22(c).

[242] 15 U.S.C. § 80a-22(e).

[243] 15 U.S.C. § 80a-22(f).

[244] 15 U.S.C. § 80a-37(a).

as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this Act * * *." The SEC is also empowered to issue rules and regulations defining terms used in the Act and prescribing forms for use in complying with the Act.[245]

Additionally, the Act gives the SEC very broad exemptive powers. Section 6(c)[246] provides that the SEC may, conditionally or unconditionally, exempt persons, securities, transactions, or classes thereof, from any provisions of the Act or from rules or regulations thereunder, where "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this Act." Exemptions may be granted by rule, regulation, or order.

Recognizing the necessity of industry reliance upon the SEC's authority, Section 38(c)[247] provides that liability may not be imposed on any person who acts in good faith conformity with any SEC rule, regulation, or order, even though subsequently amended, rescinded, or declared invalid.

The SEC has exercised the foregoing rulemaking and exemptive authority in several ways. In 1958 the SEC adopted Rule 22d-1,[248] which in most respects codified prior Commission interpretations of Section

---

[245] *Id.*

[246] 15 U.S.C. § 80a-6(c). The SEC has explicit authority to exempt funds and classes of funds from NASD sales load rules. Section 22(b)(1), 15 U.S.C. § 80a-22(b)(1).

[247] 15 U.S.C. § 80a-37(c).

[248] 17 C.F.R. § 270.22d-1.

22(d).[249] The rule permits the reduction and elimination of sales loads under certain circumstances, including, ***inter alia,*** volume purchases, dividend and capital gain reinvestments, and purchases by persons employed by the fund, its advisor, or its underwriter. Paragraph (h) of Rule 22d-1 was amended in 1971 to require that such persons be primarily engaged in the mutual fund aspects of the employer's business.[250]

Rule 22d-1 originally proscribed rather broadly the practice of "grouping" prospective fund purchasers to obtain volume discounts. An amendment proposed in 1968 would have lifted the anti-grouping rule.[251] In 1973, the Commission withdrew that proposal and substituted a less drastic change.[252] In November 1974, after years of studying the question and its possible effects on the delicate mutual fund distribution system, the Commission approved an amendment to Rule 22d-1 which allows the use of "bona fide" groups to obtain volume discounts. The "group" must have been in existence for at least six months, must have a bona fide purpose other than to purchase fund shares at a discount, and may not be composed of a particular company's creditcard holders, an insurance company's policyholders, or customers of a particular bank, broker-dealer, or investment adviser.[253]

Rule 22d-2 [254] was promulgated in early 1974 to expand upon previously granted exemptions. It allows

---

[249] Inv. Co. Act Rel. No. 2798 (1958), F.Sec. L. Rep. ¶ 76,625.

[250] Inv. Co. Act Rel. No. 6347 (1971), F.Sec. L. Rep. ¶ 77,953.

[251] Inv. Co. Act Rel. No. 5507 (1968), F.Sec. L. Rep. ¶ 77,609.

[252] Inv. Co. Act Rel. No. 7571 (1973), F.Sec. L. Rep. ¶ 79,148.

[253] Inv. Co. Act. Rel. No. 8569 (1974), F.Sec. L. Rep. ¶ 79,999.

[254] 17 C.F.R. § 270.22d-2.

reinvestment without sales charge within thirty days after a redemption of fund shares.[255] Both Rule 22d-1 and Rule 22d-2 represent efforts to codify the many SEC rulings upon Section 22(d) exemption applications filed under Section 6(c). The Commission has approved [256] and rejected [257] many such applications. Also, the Commission recently promised to (1) publish for comment a rule permitting funds to utilize "open seasons" during which persons who have held shares for a specified period might purchase specified amounts of additional shares on a reduced-load or no-load basis, (2) consider Section 22(d) exemption applications for reduced loads to unsolicited new investors, and (3) consider applications for Section 22(d) exemptions to permit sales load reductions to combination purchasers, *i.e.,* persons who have previously or contemporaneously purchased from the same retailer another investment product or an insurance product distributed by the same underwriter.[258] In 1968, pursuant to Section 22(c), the

---

[255] Inv. Co. Act Rel. No. 8235 (1974), F.Sec. L. Rep. ¶ 79,649.

[256] *E.g., Continental Assurance Co.,* Inv. Co. Act. Rel. No. 7488 (1972); *Dow Theory Investment Fund, Inc.,* 38 S.E.C. 286 (1958); *Investors Diversified Services,* Inv. Co. Act Rel. No. 1504 (1950); *Axe-Houghton Fund, Inc.,* Inv. Co. Act Rel. No. 1009 (1947); F.Sec. L. Rep. ¶ 75,740.

[257] *E.g., Midamerica Mutual Fund, Inc.,* 41 S.E.C. 328 (1963); *Investors Diversified Services, Inc.,* Inv. Co. Act Rel. No. 3015 (1960), F.Sec. L. Rep. ¶ 76,699; *Variable Annuity Life Insurance Co.,* Inv. Co. Act Rel. Nos. 2974 and 2975 (1960), F.Sec. L. Rep. ¶ 76,688; see *Mutual Funds Advisory, Inc.,* Inv. Co. Act Rel. No. 6932 (1972) (no standing); *cf. First Multifund of America, Inc.,* Inv. Co. Act Rel. No. 6700 (1971), F.Sec. L. Rep. ¶ 78,209 at p. 80,603 n.13.

[258] Inv. Co. Act Rel. No. 8570 (1974), F. Sec. L. Rep. ¶ 79,998.

SEC promulgated rule 22c-1,[259] which replaced NASD-sanctioned twice-daily, backward pricing with once-daily, forward pricing for fund shares.[260]

4. *The SEC's Current Mutual Fund Program*

The SEC's many years of regulatory control over mutual fund distribution have recently culminated in (1) its staff's 375-page study on the potential impact of a repeal of Section 22(d), released in 1972, (2) its two months' of hearings on mutual fund distribution in 1973, and finally, (3) its 135-page 1974 Mutual Fund Report and implementing letter to the NASD. This 1974 Report embodies the Commission's comprehensive "program" for the mutual fund industry in the future. The SEC contemplates the full exercise of "existing administrative powers to lay the groundwork for the *gradual and orderly* introduction of retail price competition into the mutual fund distribution system." [261]

With respect to purported restrictions on contract dealers engaging in brokered sales between investors, the SEC has decided to experiment with only limited "genuine matching." [262] The Commission has asked the NASD to issue a rule removing contract restrictions on such "matching" and has indicated a willingness to use the SEC's Section 22(f) power to ensure such a result.[263] The SEC apparently hopes that such

---

[259] 17 C.F.R. § 270.22c-1.

[260] Inv. Co. Act Rel. No. 5519 (1968), F.Sec. L. Rep. ¶ 77,616.

[261] 1974 Mutual Fund Report at v (emphasis added).

[262] Garrett letter, Add. 18-19.

[263] *Id.*

limited "matching" will not contradict the basic purposes of Section 22(d)—protection of the primary market distribution system and prevention of unjust discrimination.[264] Nevertheless, the Commission acknowledges that "it is difficult to predict the actual impact of a limited secondary brokered market for fund shares"[265] and expressly reserves the SEC's prerogative to reverse the policy change if it proves mistaken.

The SEC suggests several regulatory steps "to help neutralize any adverse impact upon the funds' primary distribution systems, and to ensure that transactions in a brokered market do not injure existing shareholders."[266] By public releases and by regulations under Section 22(f), the SEC will decide how large a transfer fee (covering both recording costs and lost underwriter revenue) may be imposed upon a brokered "match." By an interpretative rule under Section 38(a) to "safeguard against the secondary brokered market functioning like a dealer market," the SEC will prevent the inventorying of potential "match" orders and will limit the brokered market to essentially contemporaneous and fortuitous "matching."[267] By a Section 22(f) rule, a Section 6(c) exemption, or Commission supervision of the NASD rulemaking and enforcement process, the SEC will permit a "fund to restrict the transferability of its shares so as to prevent their sale in a secondary brokered market if the fund c[an] show that such a

---

[264] See pages 61-64, *supra*.

[265] 1974 Mutual Fund Report at 105.

[266] *Id.*

[267] *Id.* at 107.

market in its shares ha[s] become so extensive and price-competitive as to present a significant threat to the fund's primary distribution system."[268] Finally, the SEC will not require brokers to set up "special procedures" to match orders[269] and will make participation in a secondary brokered market "optional for brokers."[270]

Although fully apprised of the allegations in this case[271] and having transmitted a letter from its general counsel to the court below,[272] the SEC recommends no policy change with respect to distribution agreements which allegedly restrict or inhibit contract dealers' participation in the secondary inter-dealer market. It does not propose rules or regulations under Section 22(f) to prohibit any inter-dealer restrictions in presently registered distribution agreements. Nor is it asking the NASD to change its rules in this respect. Indeed, the Commission explicitly rejects, for the present, any thought of "establishing a secondary dealer market."[273]

B. The SEC Has Full Regulatory Authority Over the Conduct at Issue

This case turns primarily on the distribution agreements used by the appellee funds and other funds

---

[268] *Id.* at 108.

[269] Garrett letter, Add. 19; Inv. Co. Act Rel. No. 8570 at 5 (1974) F. Sec. L. Rep. ¶79,998 at p. 84,577.

[270] Inv. Co. Act Rel. No. 8570 at 6, F. Sec. L. Rep. ¶79,998 at p. 84,577.

[271] 1974 Mutual Fund Report at 104 *et seq.*

[272] J. App. 323.

[273] 1974 Mutual Fund Report at vii.

in the industry. These agreements, and all of their terms and conditions, were never a secret at the SEC.[274] Even before the passage of the Investment Company Act in 1940, the agreements were well known to the SEC because of their inclusion in the securities registration statements filed under the 1933 Act[275] and their discussion in the Investment Trust Study.[276] Since 1940 these agreements and amendments thereto have been a required part of the funds' 1940 Act registration statements and the funds' quarterly and annual reports under both Acts.[277] The SEC has known (1) that NASD Rule 26(c) required dealers to sign agreements with underwriters before they could sell a single mutual fund share in the primary market, (2) that underwriters were compelling dealers to sign the particular restrictive agreements disclosed in filings at the SEC, and (3) that the allegedly restrictive language complained of in this case was included in such agreements.[278]

From the time it approved Rule 26(c) in 1941 to the present, the SEC has always known that it could revoke its approval of Rule 26(c) and promulgate a superseding rule.[279] The SEC has also known that it

---

[274] Compare *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213 (1966).

[275] See page 92-93, *supra*.

[276] See page 29-30, *supra*.

[277] See page 91-92, *supra*.

[278] See page 38, *supra*.

[279] In fact, that is what happened to original NASD Rule 26(e), which was superseded by SEC Rule 22c-1, 17 C.F.R. § 270.22c-1, in 1969 after twenty-eight years. See page 96, note 237, *supra*. Alternatively, the SEC long ago could have done what it has only re-

could use Section 22(f) and its other powers to prohibit transferability restrictions imposed by contract or rule.[280] Quite consciously, the SEC until now[281] has chosen *not* to change Rule 26(c) and *not* to adopt Section 22(f) rules or regulations prohibiting or narrowing the restrictions contained in the registered distribution agreements. After all these years, it would elevate form over substance to conclude that the SEC has not—as part of its duly authorized regulatory function—approved these agreements and intended that they govern relationships in the mutual fund distribution field.

The situation with respect to these agreements is totally different from that in *Silver* v. *New York Exchange,* 373 U.S. 341 (1963), where the SEC clearly *lacked jurisdiction* to approve the conduct at issue, a particular application of stock exchange disciplinary rules. *Id.* at 357-58. The *Silver* opinion itself stated that "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, *supra.*" *Id.* at 360. Note 12 described one such "different case," namely SEC review of NASD self-regulation under the Maloney Act. *Id.* at 358 n.12. In our case, the SEC's full scope of authority over publicly filed distribution agreements and its detailed regulatory control over so many aspects of mutual fund sales, pricing, investor information, and related NASD activity makes

---

cently done, *i.e.,* request the NASD itself to change Rule 26(c). See Garrett letter, Add. 18.

[280] See page 35, note 73, *supra.*

[281] See 1974 Mutual Fund Report at 105, 105 n. 1.

this, too, the "different case" recognized in *Silver*. In the circumstances of this "different case," the SEC, not the antitrust court, has exclusive jurisdiction to balance competitive considerations with the many other public interest considerations embodied in the Investment Company Act and other federal securities laws.

This conclusion cannot be any different with respect to the unfounded allegations in appellant's complaint concerning a purported "combination" or "conspiracy" between the NASD and its members. (Count I, ¶ 17.) These allegations relate to matters fully within the SEC's exclusive regulatory authority; and, consequently, the antitrust laws should not interfere.[282] The overworked 1959 incident (J.B. 61) is actually typical of the continual SEC-NASD-NASD membership dialogue which has been the accepted pattern of cooperative regulation for many years.[283] An NASD letter (GX 18, J. App. 278) advised members that distribution agreements might be amended to prevent contract dealers from taking down shares for resale to non-contract dealers. Far from being a bad faith bypass of SEC procedures, as appellant implies (J.B. 61), the NASD letter actually relayed to NASD members *the SEC staff's view* that the agreements could and often did bar such transactions (see GX 6, J. App. 251-52) and the *SEC staff's suggestion* that investment company underwriters might amend their agreements to cover the point involved, if they had

[282] The appellant has conceded this, in great part, by abandoning the key portions of Count I—its attack on NASD rules (¶¶ 17(a) & 17 (b) and ¶ 6 of the prayer for relief). See pages 19-20, *supra*.

[283] See Hed-Hoffman, "The Maloney Act Experiment," 6 B.C. Ind. & Comm. L.Rev. 187, 211 (1965).

not already done so. (See GX 16, J. App. 274.) The SEC staff's advice was fully consistent with that agency's continuing power, particularly under Section 22(f), to regulate transferability restrictions in publicly filed distribution agreements.[284]

Appellant's allegations about NASD dissemination of misleading market information and suppression of market quotations similarly fail to recognize the SEC's exclusive authority over these subjects. The SEC keeps close watch on the current availability and nature of such material. It has ample power to correct any misimpressions or confusion and to conform market practices to the purposes of the Investment Company Act. Market information is totally regulated by the SEC, directly and through its control of NASD rules and bylaws.[285]

---

[284] Unlike *Georgia* v. *Pennsylvania R.R.*, 324 U.S. 439 (1945), any changes in the agreement restrictions, whether or not the product of collective action, would be apparent to the SEC, in any event, through public filings of the sales agreements and the amendments thereto. The market impact of such changes would always be fully within the control of the SEC under Section 22(f). Furthermore, that doctrine which permits private parties to join together to influence a government agency without risking antitrust liability (see *United Mine Workers* v. *Pennington*, 381 U.S. 657, 670 (1965)), surely authorizes their Congressionally sanctioned self-regulatory association to communicate to them the agency's response and to suggest an open and public course of action which will be fully subject to the agency's continuing scrutiny.

[285] Article XVI of the NASD's bylaws governs member-dealers' computerized over-the-counter communications network (NASDAQ), and, as with all NASD bylaws, cannot be altered without SEC approval. Section 15A(b)(12) of the 1934 Act, as added in 1964, 15 U.S.C. § 78o-3(b)(12), requires the NASD to issue rules, subject to the usual vigorous SEC scrutiny, governing the form, content, manner of dissemination, and recipients of market quotations. See, *e.g.*, NASD Rules of Fair Practice, Art. III, §§ 5-6. Investors' information continues to be channeled through prospec-

C. Antitrust Immunity Necessarily Arises Here Because the Pervasive Regulatory Control of the Conduct Alleged Is in Irreconcilable Conflict with the Antitrust Laws.

In granting the SEC its pervasive authority over the conduct in issue, Congress necessarily intended to displace the antitrust laws in this unique area. Analogous decisions by this Court and other precedents in the securities area show that the appellees' conduct should be impliedly immune from antitrust challenge and confined to the SEC's exclusive jurisdiction.

In *Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296 (1963), the government charged under the Sherman Act that Pan American, an air carrier, and W. R. Grace, a common carrier, had unlawfully agreed upon a division of South American routes between their jointly owned airline, Panagra, and Pan American itself. The government further alleged that Pan American had unlawfully used its 50% control of Panagra to prevent the latter from securing Civil Aeronautics Board ("CAB") authority to operate from the Canal Zone to the United States. This Court held that the complaint should have been dismissed because the CAB had exclusive jurisdiction of the conduct alleged.

The Court's findings in *Pan American* bear a striking resemblance to the facts of the case at bar, despite the expected dissimilarities between the airline and mutual fund industries. In *Pan American* the Court found that the Federal Aviation Act and its predecessor Civil Aeronautics Act were a legisla-

---

tuses and other sales literature, all of which must be filed with the SEC and must comply with SEC disclosure guidelines on topics such as markets for shares and pricing. See page 92, *supra*.

tive reaction to destructive competition, 371 U.S. at 301, and that they were intended to create "a regime designed to change the prior competitive system." *Id.* The CAB was cast in the role of producing "the proper degree of 'competition'" by means of regulation. Similarly, Sections 22(d) and 22(f) of the Investment Company Act are, among other things, a reaction to the destructive competition caused prior to 1940 by a secondary market in mutual fund shares.

Just as the CAB "is empowered to deal with numerous aspects of what are normally thought of as antitrust problems," *id.* at 305, so the SEC has authority, *inter alia,* to enforce the fixed-price mandate of Section 22(d) in both primary and secondary markets, to permit certain variations in fixed prices, to control methods of calculating prices, to regulate the sales load and net asset value components of prices, to regulate the activities of the NASD, to disapprove under Section 22(f) restrictions on transferability disclosed through registration statements, and to control the quality and quantity of market information available to investors. Indeed, the appellant's goal of lower sales charges for investors,[286] is a subject already entrusted to the exclusive regulatory control of the NASD and the SEC under Sections 22(b) and (c) of the Investment Company Act, as amended in 1970. Under that law, the sales loads may not be so high as to be "excessive" and not "reasonable" for investors, but the loads also may not be so low as to fail to "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters * * *." 15 U.S.C. § 80a-22(b)(1).

---

[286] Complaint ¶ 59(b), J. App. 17.

Just as the CAB in *Pan American* possessed the authority to protect the public interest in its continuing review, *id.* at 305, so the SEC has the authority to accept, suspend, or revoke the registrations of mutual funds, their underwriters, and dealers, and their industry association. Just as the "public interest" standard of the Aviation Act requires the CAB to consider "unfair methods of competition" and weigh considerations of "competition and monopoly," *id.* at 306-07, 309, so the SEC must and does weigh antitrust concerns along with other public interest considerations required by the law it administers.[287]

In *Pan American,* territorial divisions, route restrictions, and carrier affiliations, were said to be "basic in this regulatory scheme." *Id.* at 305. Similarly, mandatory resale price-fixing, restrictive distribution contracts, and self-regulation through an industry-wide organization, are "basic" to the Investment Company Act-Maloney Act scheme of mutual fund distribution. Whereas in *Pan American* the Court ruled that the acts charged were "precise ingredients" of the CAB's continuing authority, *id.* at 305, so here the District Court found that the acts alleged are precise ingredients of the SEC's continuing authority over mutual funds. Under both airline and mutual fund regulatory systems, "where the problem lies within the purview of the [federal agency] * * *, Congress must have intended to give it authority that was ample to deal with the evil at hand." *Id.* at 312. In each instance, "[i]f the courts

[287] See page 95, footnote 233, *supra; cf. **Federal Maritime Commission*** v. ***Aktiebolaget Svenska Amerika Linien,*** 390 U.S. 238, 244 (1968); ***Hawaiian Telephone Co.*** v. ***Federal Communications Commission,*** 498 F.2d 771 (D.C. Cir. 1974).

were to intrude independently with their construction of the antitrust laws, two regimes might collide." *Id.* at 310.[288]

Hughes Tool Co. v. *Trans World Airlines, Inc.*, 409 U.S. 363 (1973), relied heavily on the *Pan American* decision. The crux of TWA's antitrust complaint there was the use by Hughes Tool of its ownership of TWA to dictate the manner by which TWA acquired and financed aircraft. The Court held that the challenged actions of TWA's parent were under the continuing "control and surveillance" of the CAB and accordingly were shielded from antitrust attack. *Id.* at 366. The CAB had approved Hughes Tool's acquisition of control over TWA and retained the power "to investigate and alter the manner in which that 'control' is exercised * * *." *Id.* at 385. The CAB's order approving control "did not sanction the precise way" in which that control was later exercised. *Id.* at 379. Nonetheless, the important factor, in the Court's view, was that the alleged "conduct was *within the power* of the Board to control and was central to [its] mandate * * *." *Id.* at 389 (emphasis added). Competitive considerations were "in the mainstream" of the Board's responsibilities to the public interest. *Id.* at 382.

As the *Hughes Tool* decision pointedly observed, the *Pan American* case had immunized conduct al-

---

[288] In *Pan American*, one statutory provision clearly relieved persons complying with certain CAB orders from antitrust liability. *Id.* at 304. At least four statutory provisions in the case at bar, Sections 22(d), 22(f), and 22(b)(4) of the Investment Company Act, and Section 15A(n) of the Maloney Act amendment to the 1934 Act, explicitly or necessarily exempt practices from antitrust challenge.

legedly violative of the antitrust laws "even though the CAB had taken no action to investigate, let alone act on, the alleged misfeasance as the Board has done here for over 16 years." *Id.* at 386. In the present case, the record of agency action is even greater than in *Hughes Tool.* For thirty-five years the SEC has been controlling the pricing and sale of mutual fund shares, receiving copies of the allegedly restrictive distribution agreements, studying their effect, refusing to regulate against them, and reporting on the intended non-existence of price-competitive secondary markets. Indeed, over the last thirteen years, the SEC has published five separate studies of mutual fund distribution problems, the most recent of which is its 1974 Report. The SEC has left no doubt that the crucial issues of this case are, in the words of *Hughes Tool,* "within [the SEC's] power" and "central to [its] mandate."

The only case prior to this to consider an antitrust claim in an Investment Company Act context was *Baum* v. *Investors Diversified Services, Inc.,* 286 F. Supp. 914 (N.D. Ill. 1968), aff'd on other grounds, 409 F.2d 872 (7th Cir. 1969). After an extensive review of that Act, the district court found that the SEC has "pervasive regulatory power over [mutual fund] commission rates" and held that sales load discounts are "governed exclusively by the SEC under the Investment Company Act * * *." *Id.* at 926, 927. Consequently, a particular fund's grant of quantity discounts, being clearly subject to the SEC's rule-making power, was held to be impliedly immune from challenge under the Robinson-Patman Act, 15 U.S.C. § 13(a).

The most recent appellate decision finding implied antitrust immunity in the securities context was *Gordon* v. *New York Stock Exchange, Inc.*, 498 F.2d 1303 (2d Cir.), cert. granted, 43 U.S.L.W. 3290 (U.S. Nov. 18, 1974). The U.S. Court of Appeals for the Second Circuit held that Section 19(b) of the 1934 Act, 15 U.S.C. § 78s(b), vests the SEC with exclusive jurisdiction to determine to what extent the continued fixing of stock exchange commission rates is necessary and proper, and thereby displaces separate antitrust jurisdiction. The *Gordon* court was plainly impressed with "the wide-reaching and systematic character of recent SEC action regarding rate regulation * * *." *Id.* at 1308. Concluding that frustration of the SEC-supervised, self-regulatory aims of the 1934 Act "would be the inevitable consequence of duplicative or inconsistent standards announced contemporaneously by courts and Commission," *id.* at 1306, the court implied an antitrust immunity even though the statute contained no express exemption.[289]

On the basis of *Gordon*, the instant appeal is an *a fortiori* case for implied antitrust immunity because Section 22 of the Investment Company Act clearly commands and contemplates conduct which is inconsistent with strict antitrust standards. Indeed, here, Congress has written several express antitrust exemp-

[289] Accord, *Kaplan* v. *Lehman Bros.*, 371 F.2d 409 (7th Cir. 1967), cert. denied, 389 U.S. 954 (1967); *Stark* v. *New York Stock Exchange, Inc.*, 466 F.2d 743 (2d Cir. 1972); but see *Thill Securities Corp.* v. *New York Stock Exchange, Inc.*, 433 F.2d 264 (7th Cir. 1970), cert. denied, 401 U.S. 994 (1971); but *cf. Harwell* v. *Growth Programs, Inc.*, 451 F.2d 240 (5th Cir. 1971), rehearing denied, 459 F.2d 461, cert. denied *sub. nom., Nat'l Ass'n of Securities Dealers, Inc.* v. *Harwell*, 409 U.S. 876 (1972).

tions into the applicable statutes.[290] There is abundant evidence in this case that the Congressionally mandated, fixed-price structure of load fund distribution is "the keystone" in preserving the viability of the present system for continuously selling redeemable fund securities. See *Gordon, supra,* 498 F.2d at 1307. The SEC, with Congressional direction, is the proper agency to modulate the amount of competitive pressure and investor discrimination that this system can tolerate.

The present case is a classic illustration of how the subjection of pervasively regulated "conduct to antitrust liability would create a basic conflict with the authority of the regulatory agency" (J.B. 56). Generally, perhaps, a "regulatory scheme and the antitrust laws are presumed to be complementary, not conflicting" (J.B. 57-8); but that presumption is categorically rebutted by the regulatory facts of this case.

Since at least 1940, Congress has viewed mutual fund distribution as a special type of underwriting and has considered underwriting as a field where many of the usual antitrust strictures are not to be applied.[291] Had Congress intended the application of the antitrust laws here, it would not have sanctioned, through Section 22(f), the continuation of publicly disclosed restrictions on share transferability. Nor would Congress in Section 22(b)(1) have authorized

---

[290] See page 112, footnote 288, *supra*.

[291] See 1967 House Hearings, *supra*, at 59; *cf. United States* v. *Morgan*, 118 F. Supp. 621, 690 (S.D.N.Y. 1953).

competitors to combine through the NASD to engage in a type of cooperative ratemaking, *i.e.,* the regulation of sales loads on both the high and the low sides. Nor would Congress have granted the SEC far-reaching authority to control transferability restrictions through regulation, to grant exemptions from strict price-fixing, and to closely review and, if warranted, supersede NASD sales load rules. If Congress had intended no conflict between the antitrust laws and mutual fund regulation, it would not have imposed nationwide price maintenance on funds, underwriters, contracting dealers, and non-contracting dealers alike, through Section 22(d), nor provided severe criminal sanctions for price-cutting. In 1970, if Congress had wanted to reinstitute price competition between primary and secondary markets for mutual fund shares, it would not have reenacted Section 22(d).

The unique aspects of the load mutual fund industry—continuous offerings, compulsory redemption and the concomitant potential for self-liquidation, mandatory price maintenance in all public sales, determination of the principal price component of shares (net asset value) by supply and demand for the fund's portfolio assets, and close regulation of the sales load price component by both the NASD and the SEC—all are reasons why the Commission should exclusively control the conduct at issue here. It was because of these unique mutual fund characteristics that Congress never intended any "free and open market", in the traditional sense, for load mutual

fund shares.[292] The SEC's present regulatory program for mutual funds recognizes this intent; the appellant's suit clearly does not.

The appellant's prayer for relief herein is in plain conflict with many aspects of the SEC's carefully defined program.[293] For instance, appellant seeks to establish a broad and uninhibited "brokerage market" rather than the SEC's limited "genuine matching" market in which inventorying of orders would be prohibited and the implementation of "special procedures" would not be required. Whereas the SEC program contemplates the approval from time to time of certain restrictions on "matching," the appellant requests a perpetual injunction against all such restrictions without regard to the effect a brokerage market may have upon a fund's primary distribution system.

In short, there is a clear conflict between the SEC's exercise of "quasi-legislative" policy-making "for the gradual and orderly introduction of retail price competition into the mutual fund distribution system", 1974 Mutual Fund Report at v, and the appellant's blunderbuss approach. If the SEC is not to be hampered and circumscribed in the exercise of its regulatory authority under the Investment Company Act, the conduct at issue in this case should be reserved for exclusive SEC jurisdiction. Antitrust

---

[292] *Accord, Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Securities Dealers, Inc.*, 9 S.E.C. 38, 46 (1941).

[293] See pages 102-04, *supra*, for the detailed description of that program.

courts, operating with isolated case-and-controversy records, are ill-equipped to render the sort of policy judgments in the mutual fund area which the SEC is regularly and expertly making.[294] In contrast to the SEC's "quasi-legislative" function, "the [courts'] judicial function is traditionally to weigh the merits of particular controversies, but not to engage in a consistent determination of policy or to maintain steady contact with a general and continuing problem."[295] Unlike the SEC, antitrust courts are not equipped to host industry-wide hearings, or to assess the interrelationship of a particular practice to the structure of the total industry, or to anticipate the implications of a modification or abandonment of such a practice.[296] By way of contrast, as the SEC stated in its transmittal of the 1974 Mutual Fund Report to Congress:

> It is the genius of the administrative process that the intent of Congress can be effectuated in a complex and specialized area by an agency

---

[294] *Cf. Port of Boston Marine Terminal Ass'n.* v. *Rederiaktiebolaget Transatlantic,* 400 U.S. 62, 69 (1970).

[295] W. Gellhorn "The Administrative Agency—A Threat to Democracy?" in *Separation of Powers and the Independent Agencies: Cases and Selected Readings,* S. Doc. No. 91-49, 91st Cong., 1st Sess. at 517 (1970).

[296] With respect to price-fixing, for instance, this Court's announcement of the *per se* illegality rule in *United States* v. *Trenton Potteries Co.,* 273 U.S. 392, 397-98, (1927), was premised on the judiciary's inability to assess the reasonableness of particular types of price-fixing in different economic settings. Not surprisingly, even Congress has expressed reluctance to change the Congressionally imposed system of mutual fund price-fixing without receiving further comprehensive studies and recommendations from the SEC.

> which is provided with flexibility and discretion to adjust the law as circumstances demand. [*Id.* at viii.]

In sum, if the Congressional scheme in this complex and specialized area is to "work", *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 357, the SEC must be permitted to experiment with competition and to implement it step-by-step without *ad hoc* judgments or second-guessing by antitrust courts.[297] Balancing of all aspects of the public interest "becomes far too hazardous with two hands on the tiller * * *." [298]

CONCLUSION

The instant action is unfounded because:

(1) The challenged distribution agreements have been publicly filed in SEC registration statements for at least 35 years.

---

[297] In light of the SEC's statement on the record in the District Court, its public addresses and releases, and, most importantly, its 1974 Report, there should be no doubt that the SEC views the instant controversy as within its exclusive jurisdiction. Should there be any question about the SEC's views, the Court could still remand the matter to the District Court for a primary jurisdiction referral to the SEC. The agency could then consider, on the basis of a formal record, why exclusive SEC jurisdiction is necessary to enable the regulatory scheme to work. See *Ricci* v. *Chicago Mercantile Exchange,* 409 U.S. 289 (1973); *Chicago Mercantile Exchange* v. *Deaktor,* 414 U.S. 113 (1973). When the District Court noted that "the cases at bar do not involve the doctrine of primary jurisdiction" (J. App. 361 n.59), this indicated acceptance of the defendants' argument that the motions to dismiss could be decided by the court on exclusive jurisdiction grounds without reaching the primary jurisdiction question.

[298] *Gordon* v. *New York Stock Exchange, supra,* 498 F.2d at 1308.

(2) The restrictions in the contracts attacked as "per se illegal" are expressly sanctioned by Section 22(f) of the Act unless and until the SEC disapproves them.

(3) Prior to the District Court's decision, appellant abandoned its attack on the SEC-approved Rules of the NASD which regulate mutual fund distribution and require the use of the publicly filed agreements challenged here.

(4) The complaint seeks to require an unregulated secondary brokerage market which is contrary to the clear intent of Congress in enacting Section 22(d) to prevent the kind of price competition from a secondary market as existed in 1940 when the Act was passed. This Congressional intent was re-affirmed in 1970 when Congress re-enacted Section 22(d) in full with the unmistakable understanding that, by so doing, it was forbidding any form of intra-brand price competition in the mutual fund distribution system.

(5) Appellant has charged dealers with failure to utilize an alleged loophole in Section 22(d), even though such action might be criminal, would contravene the purposes of Section 22(d), and if carried over to other provisions of the federal securities laws, would invite a wholesale effort to evade these laws and the jurisdiction of the SEC.

(6) Appellees are thus placed between Scylla and Charybdis, forced to choose between violations of the securities laws or the antitrust laws, both of which are criminal acts.

(7) At virtually the same time that it filed this case, appellant was inconsistently urging the SEC to exercise its broad rulemaking and exemptive powers under Section 6(c) and 22(f) of the Act to accomplish much the same results.

(8) Notwithstanding appellant's efforts to derogate from the SEC's jurisdiction, the SEC continues its close regulation of the industry and is proposing to implement some of appellant's suggestions, subject to necessary safeguards and reappraisal.

(9) The SEC's chosen instrument for effecting these changes is the appellee NASD, whose self-regulatory activities are under attack in this case.

In sum, an industry whose sales and pricing practices have been minutely regulated and publicly disclosed, suddenly finds itself before the federal courts charged with "per se" violations of the antitrust laws for doing that which was sanctioned and required by federal statutes and regulations.

This entire complaint could and should have been directed to the SEC. Not only could the relief which appellant seeks be obtained from the SEC, but ironically, a major portion of that relief will soon be ordered by the SEC. If appellant remains unsatisfied with SEC regulation of the industry, its recourse is to Congress, not to the courts.

The judgment of the District Court should be affirmed.

Respectfully submitted,

LEE LOEVINGER
OWEN M. JOHNSON, JR.
DAVID J. SAYLOR
MARTIN KLEPPER
HOGAN & HARTSON
815 Connecticut Avenue, N.W.
Washington, D.C. 20006

Attorneys for Appellees:

Bache & Co. Incorporated
Dean Witter & Co. Incorporated
duPont Glore Forgan Incorporated
Hornblower & Weeks-Hemphill Noyes Incorporated
E. F. Hutton & Company Inc.
Merrill Lynch, Pierce, Fenner & Smith Inc.
Paine, Webber, Jackson & Curtis Incorporated
Reynolds Securities Inc.

BROWN, WOOD, FULLER, CALDWELL & IVEY
One Liberty Plaza
New York, New York 10006
Of Counsel for Appellee Merrill Lynch, Pierce, Fenner & Smith, Inc.

DATED:
January 20, 1975

ADDENDUM

ADDENDUM

Pertinent Provisions of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, et. seq.

Section 2(a)(11), 15 U.S.C. § 80a-2(a)(11) provides:

(11) "Dealer" means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

Section 2(a)(34), 15 U.S.C. § 80a-2(a)(34) provides:

(34) "Sale", "sell", "offer to sell", or "offer for sale" includes every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase and to have been sold for value.

Section 6(c), 15 U.S.C. § 80a-6(c) provides:

(c) The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this subchapter or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter.

Section 15(b), 15 U.S.C. § 80a-15(b) provides:

(b) It shall be unlawful for any principal underwriter for a registered open-end company to offer for

sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment.

Section 22, 15 U.S.C. § 80a-22 provides:

(a) A securities association registered under section 78o-3 of this title may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company any redeemable security issued by such company and the maximum price at which a member may sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

in each case for the purpose of eliminating or reducing as far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or

surrendering for redemption any such redeemable securities in contravention of said rules.

(b)(1) Such a securities association may also, by rules adopted and in effect in accordance with section 78*o*-3 of this title, and notwithstanding the provisions of subsection (b)(8) thereof but subject to all other provisions of said section applicable to the rules of such an association, prohibit its members from purchasing, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price, as such rules may prescribe in order that the price at which such security is offered or sold to the public shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors. The Commission shall on application or otherwise, if it appears that smaller companies are subject to relatively higher operating costs, make due allowance therefor by granting any such company or class of companies appropriate qualified exemptions from the provisions of this section.

(2) At any time after the expiration of eighteen months from December 14, 1970, or after a securities association has adopted rules as contemplated by this subsection, the Commission may make such rules and regulations pursuant to section 78*o*(b)(10) of this title as are appropriate to effectuate the purpose of this section with respect to sales of shares of a registered investment company by broker-dealers subject to regulation under section 78*o*(b)(8) of this title: *Provided*, That the underwriter of such shares may file with the Commission at any time a notice of election to comply with the rules prescribed pursuant to this subsection by a national securities association specified in such notice, and thereafter the sales load shall not exceed

that prescribed by such rules of such association, and the rules of the Commission as hereinabove authorized shall thereafter be inapplicable to such sales.

(3) At any time after the expiration of eighteen months from December 14, 1970 (or, if earlier, after a securities association has adopted for purposes of paragraph (1) any rule respecting excessive sales loads), the Commission may alter or supplement the rules of any securities association as may be necessary to effectuate the purposes of this subsection in the manner provided by section 78*o*-3(k)(2) of this title.

(4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail.

(c) The Commission may make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any securities association, to the same extent, covering the same subject matter, and for the accomplishment of the same ends as are prescribed in subsection (a) of this section in respect of the rules which may be made by a registered securities association governing its members. Any rules and regulations so made by the Commission, to the extent that they may be inconsistent with the rules of any such association, shall so long as they remain in force supersede the rules of the association and be binding upon its members as well as all other underwriters and dealers to whom they may be applicable.

(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price

described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 80a-11 of this title; (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 80a-12 of this title.

(e) No registered investment company shall suspend the right of redemption or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption except

(1) for any period (A) which the New York Stock Exchange is closed other than customary week-end and holiday closing or (B) during which trading on the New York Stock Exchange is restricted:

(2) for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or

(3) for such other periods as the Commission may by order permit for the protection of security holders of the company.

The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection. Any company which, as of March 15, 1940, was required by provision of its charter, certificate or incorporation, articles of association, or trust indenture, or of a bylaw or regulation duly adopted thereunder, to

postpone the date of payment or satisfaction upon redemption of redeemable securities issued by it, shall be exempt from the requirements of this subsection; but such exemption shall terminate upon the expiration of one year from the effective date of this subchapter, or upon the repeal or amendment of such provision, or upon the sale by such company after March 15, 1940, of any security (other than short-term paper) of which it is the issuer, whichever first occurs.

(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Section 38(a), 15 U.S.C. § 80a-37(a) provides:

(a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this subchapter, including rules and regulations defining accounting, technical, and trade terms used in this subchapter, and prescribing the form or forms in which information required in registration statements, applications, and reports to the Commission shall be set forth. For the purposes of its rules or regulations the Commission may classify persons, securities, and other matters within its jurisdiction and prescribe different requirements for different classes of persons, securities, or matters.

Section 38(c), 15 U.S.C. § 80a-37(c) provides:

(c) No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, by amended or rescinded or be determined by

judicial or other authority to be invalid for any reason.

Section 48(a), 15 U.S.C. § 80a-47(a) provides:

(a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this subchapter or any rule, regulation, or order thereunder.

Section 49, 15 U.S.C. § 80a-48 provides:

Any person who willfully violates any provision of this subchapter or of any rule, regulation, or order hereunder, or any person who willfully in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter or the keeping of which is required pursuant to section 80a-30 (a) of this title makes any untrue statement of a material fact or omits to state any material fact necessary in order to prevent the statements made therein from being materially misleading in the light of the circumstances under which they were made, shall upon conviction be fined not more than $10,000 or imprisoned not more than two years, or both; but no person shall be convicted under this section for the violation of any rule, regulation, or order if he proves that he had no actual knowledge of such rule, regulation, or order.

Pertinent Provisions of the Maloney Act of 1938, As Amended, 15 U.S.C. § 78o-3

15 U.S.C. § 78o-3(b) provides:

An applicant association shall not be registered as a national securities association unless it appears tô the Commission that—

(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this chapter and the rules and regulations thereunder and to carry out the the purposes of this section.

(2) such association is so organized and is of such a character as to be able to comply with the provisions of this chapter and the rules and regulations thereunder, and to carry out the purposes of this section.

(3) the rules of the association provide that any broker or dealer who makes use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may become a member of such association, except such as are excluded pursuant to paragraph (4) or (5) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section. Rules adopted by the association may provide that the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public interest so to direct, deny admission to or refuse to continue in such association any broker or dealer if—

(A) such broker or dealer, whether prior or subsequent to becoming such, or

(B) any person associated with such broker or dealer, whether prior or subsequent to becoming so associated,

has been and is suspended or expelled from a national securities exchange or has been and is barred or suspended from being associated with all members of such exchange, for violation of any rule of such exchange.

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if such broker or dealer—

(A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange or has been and is barred or suspended from being associated with all members of such association or from being associated with all brokers or dealers which are members of such exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade.

(B) is subject to an order of the Commission denying, suspending for a period not exceeding twelve months, or revoking his registration pursuant to section 78*o* of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or barring or suspending him from being associated with a broker or dealer.

(C) whether prior or subsequent to becoming a broker or dealer, by his conduct while associated with a broker or dealer, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such broker or dealer, and in en-

tering such a suspension, expulsion, or order, the Commission or any such exchange or association shall have jurisdiction to determine whether or not any person was a cause thereof.

(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who, if such person were a broker or dealer, would be ineligible for admission to our continuance in membership under clause (A), (B), or (C) of this paragraph.

(5) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated with a member in conformity with specified and appropriate standards with respect to the training, experience, and such other qualifications of such person as the association finds necessary or desirable, and in the case of a member, the financial responsibility of such member. For the purpose of defining such standards and the application thereof, such rules may—

(A) appropriately classify prospective members (taking into account relevant matters, including type of business done and nature of securities sold) and persons proposed to be associated with members.

(B) specify that all or any portion of such standards shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules.

(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members)

of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate.

(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the training, experience, and other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association may adopt procedures for verification of qualifications of the applicant.

(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by such rules (and any application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of subsection (a) of section 78ff of this title, be deemed an application required to be filed under this chapter).

(6) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

(7) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration.

(8) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issues, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to

impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

(9) the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

(10) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and persons associated with members and the denial of membership to any broker or dealer seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include—

(A) a statement setting forth any act or practice in which such member or other person may be found to have engaged, or which such member or other person may be found to have omitted.

(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation.

(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade.

(D) a statement setting forth the penalty imposed.

In any proceeding to determine whether a broker or dealer shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the broker or

dealer or person shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial or bar is based.

(11) the requirements of subsection (c) of this section, insofar as these may be applicable, are satisfied.

(12) the rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be disseminated by any member or any person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, both at the wholesale and retail level, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting and publishing quotations. The provisions of this subsection, as in effect prior to August 20, 1964, shall be applicable to the rules of any registered securities association which was registered on such date until July 1, 1964. After July 1, 1964, the Commission may, after notice and opportunity for hearing, suspend the registration of any such association if it finds that the rules thereof do not conform to the requirements of this subsection, as amended by section 7 of the Securities Act Amendments of 1964, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.

15 U.S.C. § 78o-3(j) provides:

Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission

may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a) of this section. Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsections (b) and (d) of this section.

15 U.S.C. § 78o-3(k) provides:

(1) The Commission is authorized by order to abrogate any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or effectuate the purpose of this chapter.

(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested, or with such modifications of such alteration or supplement as it deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to—

(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with

members, or the qualifications required for members or natural persons associated with members or any class thereof.

(B) the method for adoption of any change in or addition to the rules of the association.

(C) the method of choosing officers and directors.

(D) affiliation between registered securities associations.

15 U.S.C. § 78o-3(n) provides:

If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provisions of this section shall prevail.

S.3580, 76th Cong., 3rd Sess. § 22 (Introduced March 14, 1940) (Proposed by SEC) (Not Enacted)

SEC. 22. (a) No registered investment company or principal underwriter therefor shall sell, redeem, or repurchase any redeemable security of which such a company is the issuer, except at a price bearing such relation to the current asset value of such security, computed as of such time, as the Commission shall prescribe by rules and regulations or orders, for the purpose of eliminating or reducing to a practical minimum any dilution of or accretion to the current asset value of any other securities of such company as a consequence of such sale, redemption, or repurchase.

(b) No underwriter or dealer, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, shall purchase any such security from the issuer or from any underwriter except at the price at which he sells such security, less a commission or spread allowed him by the person selling to him.

(c) If at any time the Commission has reason to believe that any redeemable security is being offered for sale or sold to the public by the issuer or any underwriter at a price which includes an unconscionable or grossly excessive sales load, the Commission shall cause to be served upon the issuer (or if the issuer is a unit investment trust, upon its depositor), and upon every principal underwriter for the issuer, a notice to appear and show cause why such sales load should not be prohibited. If, after hearing the evidence, the Commission finds that the issuer or any principal underwriter therefor is selling such securities to the public at a price including an unconscionable or grossly excessive sales load, the Commission shall order such company, underwriter, or underwriters, as the case may be, to cease and desist from selling at such price. In determining whether a sales load is unconscionable or grossly excessive, due weight shall be given to the incidents, denominations, and selling

price of the securities involved, to the organization, investment policy, past and prospective earnings, management expenses, and management and sales methods of the issuer, its managers, depositors, underwriters, and dealers and its and their competitors, and to such other factors as are relevant in the particular proceeding.

(d) The Commission is authorized, by rules and regulations or order in the public interest or for the protection of investors, to prohibit—

(1) the suspension, in whole or in part, of the redemption privileges of any redeemable security of which any registered investment company is the issuer; and

(2) restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer.

Add. 18

Letter, Ray Garrett, Jr., SEC Chairman

to

Gordon Macklin, President, National Association of Securities Dealers, Inc.
November 22, 1974

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

November 22, 1974

Mr. Gordon S. Macklin
President
National Association of
Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Macklin:

On November 4, 1974, the Commission transmitted to Senator John Sparkman, Chairman of the Senate Committee on Banking, Housing and Urban Affairs, a staff report entitled "Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940" ("Staff Report").

That report, among other things, recommended that the Commission request the NASD to amend its Rules of Fair Practice to prohibit its members from being parties to agreements which restrict broker-dealers, acting as agents, from matching orders to buy and sell fund shares in a secondary market at competitively determined prices and commission rates.

The Commission has considered that recommendation and, although the Rules of Fair Practice do not require that agreements between fund underwriters and broker-dealers contain such restrictions, it believes that sound regulatory policy dictates the elimination of any such

restrictions. As the staff's report suggests, however, action in this area should also include steps to help to neutralize any adverse impact on the funds' primary distribution systems and to ensure that transactions in a brokered market are in the interest of all of the holders of the funds' outstanding shares. For example, funds would be permitted to impose reasonable service fees when ownership of their shares is transferred in this manner. In the absence of any underwriters' spread on the sale, such fees could include the cost of recording the transfer as well as an amount to compensate the underwriter, to some extent, for promotional services. To ensure that broker-dealers engage only in the genuine matching of orders, they should not be permitted to fill orders to buy or sell fund shares more than one full business day after such orders are received. Nor should broker-dealers be required to set up special procedures to match orders for fund shares.

Accordingly, in order to implement the foregoing, we ask your assistance and request the NASD to amend its Rules of Fair Practice as suggested above and as outlined in detail in the Staff Report.

Sincerely,

/s/ Ray Garrett, Jr.
RAY GARRETT, JR.
Chairman